

Current Problems (*) of Co-operation Between Central Banks

1. *Certain characteristic features of co-operation between central banks today are reminiscent of the twenties*

At the present time the situation in regard to co-operation between central banks (which is obviously international) is characterised by both structural and functional elements.

So far as structural elements are concerned, it should be noted in the first place that central banks are the monetary advisers to their governments (a position held by them by virtue of explicit laws in some countries), so that no decision in the monetary field is taken by a treasury without consulting the central bank. The central banks, as advisers or even agents of their governments, thus stand in the forefront of the monetary and financial co-operation which is practised among vast groups of countries.

On the other hand, the favourable economic trend that has been evident in western Europe for some years has led not only to convertibility but also to the consolidation of high levels of national income and employment, so that the reappearance of the theory of the exclusive priority and autonomy of domestic credit policy need not be feared, at least for the time being. Neither need there be any fear of the reappearance of the theory of autonomous national foreign exchange policies, as effected by freely fluctuating exchange rates. These cannot be said to have ever really functioned as such, if one does not wish to exaggerate and systematise the

* This article represents the second half of a lecture entitled "International Co-operation and Harmonisation in Central Banking", delivered in March 1961 at the Bologna Centre of the School of Advanced International Studies of the Johns Hopkins University. The opinions expressed are strictly personal and should not be regarded as representing the views of the institution to which the author belongs.

more or less self-moderating exchange variations of the period from 1931 to 1936 or to concentrate unduly on the aspects rather than on the aims of European monetary systems between the end of the first world war and the stabilisation of the twenties.

The actual resumption by the central banks of control over the instruments for influencing the money market and the efficient rôle they played in stemming or overcoming post-war inflation have brought out once more — albeit in a new institutional context — certain old theories which were discussed and tried out experimentally in the twenties. In those years, in fact, concrete action was taken with a view to introducing active co-operation between central banks, mainly on the initiative of Montagu Norman, Governor of the Bank of England at that time, and Benjamin Strong, the Governor of the Federal Reserve Bank of New York (1). The thirties, on the other hand, were certainly not a favourable period for central banks, whose rôle — as was also true for monetary co-operation in general — appeared to decline in importance.

If, then, the philosophy of today's international institutions for monetary co-operation is examined, the aim can be discerned of preventing a return of the evils which afflicted the thirties. Thus the "psychological suppression" of that period brings us back, by another path, to the twenties. At that time, after the achievement of monetary stabilisation all over Europe, the maintenance of a reasonable degree of stability of monetary parities became an acknowledged necessity. From being a tacit prerequisite for the functioning of the pre-war gold standard, such stability became an explicit condition for the functioning of the later gold exchange standard and for the development of co-operation between the banks.

Even today this prerequisite still applies, and the maintenance of a system of stable and orderly parities constitutes one of the very *raison d'être* of the institutions for economic and monetary co-operation. Only when this is taken as given is, in fact, any monetary co-operation conceivable. The European monetary picture today presents a dual institutional structure; the broader framework is provided in part by the International Monetary Fund (whose objects include the maintenance and regulated adjustment of parities and the pro-

(1) Examples of co-operation between central banks are the revolving credit granted by the Federal Reserve Bank of New York to the Bank of England in 1925 and the stabilisation loans extended by a group of central banks to the national banks of Belgium, Italy, Poland and Rumania.

vision of liquidity in case of need), and the other, more restricted, one is formed by the European Monetary Agreement, which was planted and has developed in the fertile soil of the economic and trade co-operation within the framework of the O.E.E.C. The final settlement of international financial transactions and the formation of monetary reserves within this area are substantially governed by a "double standard", namely gold and the dollar, both of which are fundamentally interrelated in value, both in the eyes of the public and in the rules governing international institutions and economic agreements.

2. Further consideration of monetary co-operation in the twenties

If it is accepted that past experience may, if regarded judiciously, have value for our own times, it would seem useful to refer briefly to the situation in the twenties, which provided examples of and efforts towards co-operation between central banks that were more than just incidental. If we look at the statements made by the two foremost apostles of such co-operation, Governors Norman and Strong, we find that the need for co-operation was very strongly stressed, even if there was a certain vagueness as regards its form and mode of application.

This having been said, it is not difficult to try to reconstruct the basic essentials of that co-operation, which seem to me to have consisted of two sets of operative principles: the first concerned the proper functioning of the gold exchange standard and the second a more or less specific collaboration between banks. Let us consider each of these principles. Under the first heading we may include:

(a) the action directed towards avoiding a scramble for gold, by co-ordinating the gold purchases of central banks; going one step further, an attempt was even made to avoid the actual use of gold and to replace it by key currencies (2);

(2) P. EINZIG refers directly to a meeting "held in August 1927, in Washington, when an agreement was reached between central banks not to interfere with each other's gold reserve without each other's consent". (France apparently did not subscribe to this agreement). "Moreover, most central banks went so far as to refrain from buying gold in the open market in London without the consent of the Bank of England. A practice developed by which the Bank of England bought gold in the open market on account of various continental central banks...". Cf. P. EINZIG: *Montagu Norman*, London, 1932, pp. 89-91. Although I have failed to find any substantiation of Dr. Einzig's assertions elsewhere, it is nevertheless

(b) the action aimed at making central banks operate only among themselves and avoid direct business relations with foreign commercial banks; the primary aim of this was to enable better knowledge to be acquired of the volume and form of the foreign central-bank short-term funds existing in each country.

The other set of principles consisted essentially in the desirability for central banks to keep each other continually informed of the "modus operandi" of their credit policies and, in particular, to inform each other in advance of possible changes in discount rates. I shall come back to this point, but, in order to complete this reference to an instructive period of the past, I should like to recall how Norman and Strong in practice visualised contact between central banks. It may be said at once that the former conceived of this contact as something which should take place in small groups, a few at a time, always informally, whether within or outside the framework of the Bank for International Settlements, of which Norman was one of the architects. On this subject Strong had very similar ideas (3).

Again, in the field of proposals for co-operation, mention should be made of the experiment of the Bank for International Settlements,

interesting to quote them, as being highly indicative of the way of thinking of a time which was very close to the date at which the book was written.

(3) O. ERNEST MOORE, one of Strong's secretaries, summarised the ideas expressed by the latter at an international meeting: "Governor Strong stated that he had always been opposed to any sort of formal conference or meeting between the world central banks... he was not at all convinced that at a general meeting or in any common organization of central banks the policy of certain banks would not be dictated by the interest of their respective governments rather than by purely monetary considerations". (Cf. L. V. CHANDLER: *Benjamin Strong, central banker*, Washington, 1958, p. 280). Referring to the Bank for International Settlements before the Macmillan Committee, MONTAGU NORMAN said: "A central bank governor, when he comes to Basel, is necessarily to a certain extent dominated by the particular state of his own fiscal and economic situation at home, of the mind of his public, of the mind of his Government, and it is a matter therefore, not, as I say again, of establishing personal friendships... but of taking up questions which are international and regarding them, as one would say, on their merits... There is no such thing as merits when you come to that. To get the affairs of a country, and possibly the needs of a country, considered on their merits is a thing which has not been achieved, and, I believe, will not be achieved, for a very long time. The moment the position of certain countries is mentioned you get a reaction for or against, for particular reasons applicable to the individual in whom the reaction takes place. *There will be a new Europe before we get away from that* (our italics)... So far as the co-operative relations between any couples of banks or three banks are concerned, there, I think, already in most circumstances a considerable amount of progress had been made...". Cf. Committee on Finance and Industry, *Minutes of Evidence*, London, 1931, Vol. I, pp. 298-299.

which unfortunately, soon after its foundation, was caught up in the maelstrom of the critical decade of the thirties, during which it was not so much a question of monetary co-operation as of the survival of an international monetary order. The attempts made by the Bank for International Settlements at the beginning of its activity towards achieving a more efficient system of international payments have been dealt with elsewhere, and therefore, in so far as it has a bearing on the present study (marginally at any rate), I need only refer to a previous article (4).

3. *The harmonisation of discount rates*

As was observed in one of the Memoranda of Evidence submitted to the Radcliffe Committee by the Bank of England, "no factor in monetary control has been the subject of more debate in recent years than the influence of interest rates" (5). In particular, the official discount rate, which has come into its own again everywhere in the last decade, after lying dormant for almost twenty years, was a subject of special consideration.

Changes in the discount rate, as is well known, may produce effects:

- (a) of an internal character (by making money more or less dear);
- (b) of a direct external character (by attracting, or repelling, foreign — and domestic — funds to, or from, the country;
- (c) of an indirect external character (for example, by bringing about, on other markets, capital movements in the opposite direction to those indicated under (b)).

In the light of these different effects, taken both separately and in combination, recourse to a change in the discount rate was often similarly interpreted as being due to causes of external or internal origin. Morgenstern, for instance, quotes official statistics (of 1912) of the Reichsbank for the period 1876-1910, in which discount-rate increases are classified according to whether they were occasioned

(4) A. FERRARI: "L'evoluzione della cooperazione monetaria internazionale e gli inizi della Banca dei Regolamenti Internazionali", in *Bancaria*, February 1961.

(5) Cf. Committee on the Working of the Monetary System, *Principal Memoranda of Evidence*, London, 1960, Vol. I, p. 36.

by external or internal factors (6). Eighteen years later, Governor Norman stated before the Macmillan Committee that in the post-war period the Bank of England had fixed the discount rate on the basis of predominantly external considerations (7). This statement appears to be in line with the classical theory, according to which under the gold standard, as under any fixed exchange-rate system, the money supply would be determined mainly by the balance of payments (8). Beyond this, central banks ought to raise or lower their domestic assets by an amount greater in volume than that of the gold and foreign exchange flowing into or out of the country. To this end, changes in discount rate were clearly "designed to make borrowing from the central bank either more or less attractive" (9). Hence the priority of external influences.

Yet, it is by acting on the domestic economy — as has been repeatedly stressed by the B.I.S. in its annual reports — that the balance of payments is kept under control, and remedial action, when necessary, should be essentially internal. Typical, in this context, is the case of inflation, which in open economies tends to reveal itself in the depletion of reserves before it shows itself in the price level.

In any case, the diagnosis of external influences is not so easy as one might think; there is, it is true, the repercussion of the internal situation on the external, and there may also be the impact of purely external phenomena on the internal situation.

Thus, at least an *impression* of the essentially *ambivalent* nature of an instrument such as the discount rate can be formed, both in its causes and in its effects; both the latter may be of an internal or external character. Of course, it is necessary at once to take account of the existence of monetary *convertibility*, at least external convertibility, and this not so much because of the pledge of punctual conversion of national currencies into an international monetary standard but also, and above all, because of the moral paraphernalia which

(6) Cf. O. MORGENSTERN: *International Financial Transactions and Business Cycles*, Princeton, 1959, pp. 364-65. I think it would have been correct to stress the fact that under the gold standard of that time, *with gold coins in circulation*, the boundaries between external and internal convertibility were far less strict than they became later. In any case the internal causes which had been put forward by the Reichsbank were of a wholly different character from those connected with the general economic situation of the twenties.

(7) Cf. *Minutes of Evidence*, Vol. I, *op. cit.*, p. 212.

(8) Cf. R. NURKSE: *International Currency Experience*, p. 66.

(9) *Ibid.*, p. 67.

usually accompany convertibility. I am referring, to be explicit, to the reasonable expectation of stable exchange parities and of a wide degree of freedom for visible and invisible transactions, and to the elimination of risks of the freezing or seizure of foreign assets — foreign balances “in primis”. Without external convertibility, there is in fact no possibility, strictly speaking, of attracting funds from abroad by means of discount-rate manipulation.

This said, it must be pointed out that discount-rate manipulation may be studied or even tried out *by degrees*. There would appear to be scope for possible co-ordination both in *depth* and on the *surface*.

(a) *Co-ordination in depth*

The discount-rate instrument — considered in depth — is directed ultimately at the *volume of credit*, which, through changes in its cost, is caused to be in greater or less demand, and also, as many would put it, made available in greater or less measure. Even when the discount rate is changed for reasons connected with the balance of payments, the latter will be influenced by its effects on the country's general economy (10). In the light of this, therefore, to speak of harmonisation of discount-rate policies amounts, in essence, to speaking of harmonisation of national credit policies, in which — and here one may argue at length — other credit and fiscal instruments can have equal or even greater weight.

Thus presented, the problem goes beyond the sphere of action of the central bank, mainly on account of the complexity of the interests involved. Really we enter here the field of co-ordination of economic or even development policy, a co-ordination which is pursued by some international economic institutions, particularly those of a regional character. Rules and principles of “good conduct” are being discussed.

In this extremely wide field (in which, within the various individual countries, the relationships and powers of the public or quasi-public authorities concerned are never perfectly clear-cut, as they

(10) In certain cases the question may arise whether it is worth acting on the economy of a country as a whole merely for balance-of-payments reasons. A particular case in point is when the causes of the disequilibrium are of a local and narrowly-circumscribed nature, not to mention that in some countries the foreign component in the gross national product may be of little importance.

depend partly on de facto situations) it is worth considering the great extent to which the central banks may be said in any case to be vested with largely autonomous powers of decision and reaction in response to (i) phenomena relating to the balance of payments, especially in so far as they affect the state of the monetary reserves, and (ii) phenomena of an inflationary or deflationary character.

The phenomena mentioned here have been grouped in two classes, mainly for traditional reasons: they could well be combined into a single category: the second. In fact the balance of payments represents only one of the components of monetary liquidity, i.e. the foreign component. The others are — as is known — public finance and the commercial banking system. If it is accepted that inflationary or deflationary impulses, coming from abroad or from the public or the private sectors, are to be neutralised or cured, it follows that the automatic nature of certain “rules of the game” in international monetary relations not only has to be adapted to meet new situations but even radically revised (11). In other words, it may be asked whether a possible co-ordination of monetary policies — of which manipulation of the discount rate is but one instrument — has to take effect, so to speak, horizontally, i.e. on the individual foreign components of the liquidity of each country or on the net liquidity that results from having the various components

(11) Before 1914 and during the twenties most, if not all, of those responsible for monetary policy (with the exception of STRONG, who, however, justified himself on the basis of the argument that the United States was, immediately after the war, the only major country with convertible currency) continued to extol the wisdom, from the monetary viewpoint, of the gold standard and the “automaticity” of its rules. Several doubts were, however, raised, particularly in certain studies written after the abandonment of the gold standard, and the least we can say, to judge by the conclusions of these studies, is that the last word has not yet been delivered on the exact way in which these rules worked. NURKSE (*op. cit.*) observed, with reference to the interwar period, that the correlation between changes in foreign assets and changes in domestic assets often did not correspond with the rules of the game; similar observations were made by BLOOMFIELD in respect of the period from 1880 to 1914 (cf. A. I. BLOOMFIELD: *Monetary Policy Under the International Gold Standard, 1880-1914*, New York, 1959). BAFI, who made a critical examination and a more refined analysis of the statistical material used by the two above-mentioned authors, adding further observations in respect of the period from 1950 to 1958, came to substantially the same conclusions. BAFI also sides with NURKSE and BLOOMFIELD in recognising that the purely statistical results must be viewed with considerable caution. He throws out an interesting explanation based on the autonomous variability of the main components of monetary liquidity, between which there could be a process of reciprocal compensation. (Cf. P. BAFI and A. OCCHUTO: “La componente esterna della liquidità e le regole della condotta monetaria”, to be published in the next issue of *Giornale degli Economisti*).

thereof brought together and offset in each national context. At this point it becomes necessary to re-establish certain "rules of the game", without which it is impossible to pass any critical comparative judgement or to exert any form of moral suasion on individual national credit politics. Any consultation and exchanges of views, or even critical appraisals, must be put on a firm basis, as otherwise hardly anyone would be prepared to make immediate sacrifices in the general interest, if he could not be sure that in a similar situation in the future others would be prepared to do the same. If principles are lacking, let alone precise rules, good reasons can always be found for not doing something that is not to one's liking or not convenient. At this point it should be mentioned, incidentally, that in the field of international co-operation progress has only been made when rules and rigid multilateral machinery have been devised and operated (as for instance in the case of the O.E.E.C. Liberalisation Code, the E.P.U. and the E.E.C., although all of these contemplated or contemplate exceptions and concessions — of course of a temporary nature).

(b) *Co-ordination on the surface*

Apart from the above-mentioned co-ordination of economic and monetary policies, the complete realisation of which would be of far greater significance than, for instance, any ambitious project for a single international currency, there can also be co-operation of a less profound nature, still, of course, between sovereign states. There can, that is to say, be a co-ordination of monetary policies designed primarily to prevent any action taken in the financial field from having detrimental effects on other countries. Such monetary policies, if they are not to be the crude expression of nationalistic power politics (pursued, in this case, with monetary weapons), presuppose, of course, the existence of an institutional arrangement such as the gold standard of former times or the system that has arisen in our day as a result of the acceptance of the rules of the International Monetary Fund. These rules, as has already been mentioned, also cover measures which enter the sphere of governmental responsibility and on which we cannot therefore dwell in detail, as we are concentrating in this context on the field of central banking. The fact remains, however, that, as far as exchange rates are concerned, the action taken by the International Monetary Fund tends, directly

or indirectly (12), to lay a foundation on which subsequent co-operation between central banks can be built.

In an attempt to visualise a sort of half-way house between the clear-cut idea of a systematically co-ordinated international economic and monetary policy and the vagueness of much of the general talk of co-operation between central banks, in which it is so fashionable to indulge, the possibility of a harmonisation of discount rates might be considered. The discount rate is the only instrument of central-bank policy of an ambivalent character — its effects are both *external* and *internal*. The other measures of central-bank policy are, according to Morgenstern's classification (13), either predominantly internal or predominantly external, and the latter, apart from direct measures

(12) Apart from the functions which it performs when a change is made in the parity of a currency and the rules it lays down regarding the maintenance of orderly cross rates, the Fund, by waging a continual war against foreign exchange restrictions, multiple exchange rates, etc., indirectly makes a concrete contribution towards the attainment of realistic exchange parities. For it is precisely by means of controls and other devices that artificial exchange parities can be maintained. It may also happen that through the pursuit of a uni-directional economic and/or credit policy a currency may be kept internationally over- or undervalued.

(13) Cf. O. MORGENSTERN: "International Financial Transactions and Business Cycles", p. 368.

List of instruments of central-bank policy

I. *Chiefly domestic*

- (1) Open-market policy.
- (2) "Private" rates, i.e., discriminatory rates of discount below or above the official rate.
- (3) Subsidiary rates, e.g., "lombard" rates, "advances" rate, etc.
- (4) Quantitative regulation of amounts of bills discounted.
- (5) Type of bills admitted, especially regarding maturity; imposition of length of loan.
- (6) Tie-in of discounts and discount rate with interest rates at open market, e.g., by custom or law.
- (7) Regulation of minimum balances or reserves required of commercial banks at central bank.
- (8) Moral pressure upon commercial banks, brokers, etc.

II. *Chiefly foreign*

- (9) Premium on gold sales and purchases.
- (10) Administrative means (other than 9) for attracting and repelling specie, including sterilisation of gold.
- (11) Foreign exchange bills bought and sold.
- (12) Forward operations in foreign exchange.
- (13) Co-operation (by negotiation, treaty, or through international bank) with other central banks.

III. *Domestic and foreign*

- (14) Discount rate.

of an administrative nature, which can be drastic in their effects, do not have the same force — nay, the weight of tradition — behind them as the discount rate.

However this may be, the dual character of the discount rate makes it more difficult to bring various countries' rates into line with each other, since it may prove harder for countries to subordinate domestic economic requirements to the need for international co-operation, should a conflict arise. In practice — and it is for this reason that I spoke of co-ordination “on the surface” — attention is focused solely on the part played by the discount rate in attracting or repelling short-term funds from foreign countries. (But other, less striking, measures of central-bank policy, specifically designed to facilitate or impede this influx, may also properly be considered. For example, discriminatory interest rates may be imposed or a system of compulsory reserves decided upon for funds derived from abroad; the central bank may provide forward cover, at varying rates, for short-term currency investments; finally, the central bank may not allow commercial banks to maintain a net debtor position in foreign exchange or it may even impose “debtor” interest rates on foreign deposits. What would, however, be highly disputable would be to combat an influx of more or less “hot” money by means of parity variations).

From the external viewpoint, the discount rate may be regarded as equivalent, on the monetary plane, to certain other measures of an administrative nature which can be used to influence the balance of payments directly, just as if this were a separate economic entity. For, when monetary reserves are falling steadily, no great ultimate difference is discernible between action designed to attract funds from foreign countries to meet a deficit in the balance of payments and protectionist moves aimed at accomplishing the same thing by the imposition of foreign exchange restrictions (which, in cases of this kind, are also permitted by the existing institutions and international agreements) (14). Both the attraction of funds and the imposition (or reimposition) of restrictive measures should be of a temporary nature, enabling more serious measures to be taken in the

(14) Cf., for example, Article VIII of the Articles of Agreement of the International Monetary Fund; Article XII of the General Agreement on Tariffs and Trade; Articles 3 and 4 of the O.E.E.C. Code of Liberalisation; Articles 108 and 109 of the Treaty establishing the European Economic Community.

meantime to restore internal equilibrium. Now, when foreign exchange restrictions — or trade restrictions (adopted also for balance-of-payments reasons) — are imposed, special procedures and consultations between nations are often contemplated within the framework of certain international agreements (15).

Although there is no obligation to consult other countries when changing the discount rate, nor any other international agreement on this subject, discussions and arguments in favour of bringing these rates into harmony become at times quite heated.

Some people, of course, believe that the discount rate should be raised or maintained at a high level only when the balance of payments of the country in question is in deficit. If a country which is running a surplus keeps its discount rate at a high level (in order to restrict the volume of internal credit, for example), this has a harmful effect on countries which are running a deficit, both because it causes a drain on the outstanding international reserves of gold and foreign exchange (and sometimes also on their domestic monetary reserves) and because it forces them to try to obtain (or to retain) foreign funds by pushing their rates up and up in competition with other countries.

All this theory, when analysed in greater detail, appears somewhat one-sided and even superficial in that it tends to place the emphasis on a single instrument of central-bank policy (16) — an instrument to which, by virtue of its historical tradition and, one might say, its symbolical significance, more importance is attributed than it really possesses in the institutional pattern of the present-day monetary systems. A change in the discount rate, of course, almost always follows and supplements other measures designed to influence the volume of payment media on the market, so that, as a factor influencing the cost of money, it is, to use legal terminology, more

(15) It should further be noted that the discount rate may be employed not only in order to attract funds from foreign countries but also, at times, to discourage them. On the other hand, the inflow or outflow of capital from or to foreign countries can also be facilitated by administrative measures.

(16) Cf. for example, the statement made by the Governor of the Bank of England to the Radcliffe Committee, reproduced in *The Committee on the Working of the Monetary System, Minutes of Evidence*, p. 152: “... I think our objectives throughout are almost exactly as you have stated them: moderating demand and maintaining stability in the economy, keeping the value of the pound internally and externally... I have said many times, both in this room and in public, that I never believed that the whole of those objectives could be secured through monetary measures and the use of Bank rate alone”.

of a *declaratory* than of a *constitutive* nature. It should, moreover, be added that some countries make it a practice to leave the discount rate unchanged as far as possible, even though they may in other respects be pursuing a flexible credit policy.

Looking at the problem of the harmonisation of discount rates from every angle, one inevitably returns, sooner or later, to the concept of co-ordination "in depth" of economic and monetary policies.

This having been said, however, an attempt will now be made — on a less ambitious scale — to consider the question of the external harmonisation of discount rates by examining what central banks can do, in practice, to regulate international short-term capital movements, in the interests of all, with the sole aid of this instrument which is peculiar to them — the discount rate.

4. *Movements of short-term money and the discount rate*

It must first of all be asked what movements of short-term funds represent in the context of the monetary system at present governing the action of members of the International Monetary Fund (and the European Monetary Agreement). Under the classical gold standard such movements occurred when the gold points were reached, at which time the central banks of the countries concerned, if they wished to prevent an outflow (or inflow) of gold, adjusted the official discount rate in order to increase or decrease the attractiveness of the market in question for short-term foreign capital (17). There was, moreover, a constant tendency to move funds towards the money markets of the reserve centre countries, which, aided by the fact that they were structural creditors, were better able to act as world bankers.

Today, almost all countries still have a framework of exchange controls, even if such controls are not always firmly enforced in practice. Incidentally, if convertibility were everywhere only *external* it would be difficult to see where short-term capital seeking investment on international markets could legitimately come from; fortunately there are also countries with full currency convertibility!

(17) Cf. C. IVERSEN: *Aspects of the Theory of International Capital Movements*, London and Copenhagen, 1935, p. 521.

Moreover, countries can always, of course, invest part of their official monetary reserves at short term in the reserve centre countries.

However, the short-term funds which are at present on the move are usually either private funds that are attracted by advantageous interest-rate differentials or public funds that should rightly be channelled through international institutions or employed in connection with specific intergovernmental payments agreements. In any case, there is no incentive for private funds to move towards countries experiencing balance-of-payments difficulties, because, for one thing, there is always the fear that they may be blocked or that there may be difficulties in retransferring them. We are, of course, not considering movements induced by expectations of possible changes in parities. It is thus becoming to an ever-increasing extent the special task of the International Monetary Fund (and, to a lesser degree, of the European Monetary Agreement) to take steps in the financial sphere to counter balance-of-payments disequilibria. In this sense the resources of the International Monetary Fund may rightly be regarded by member countries as a second line of reserves, to which they may have recourse for reasons connected with their *current* balance of payments. In this context reference may be made to the European Payments Union, now dissolved, which formerly acted as an impartial agent for distributing to debtor countries current-account credits derived, for the most part, from creditor countries.

In the case of the International Monetary Fund the granting of such credits (which might be defined as international public credits) is made dependent, especially if the amount utilised exceeds a certain proportion of the quota of the country concerned, on the preparation by that country of a plan for setting its balance of payments to rights; the credits are thus open, in principle, to all members of the Fund, however attractive or unattractive their respective markets may be to lenders of private short-term capital. Private capital may thus move only where the investment is safest and the yield highest.

At this stage the problem may become twofold:

(a) Funds may move towards reserve centre countries, in their capacity as international bankers. In so doing, they will be taking the same course as that part of the official monetary reserves which the depositor countries wish to invest abroad and not to keep in gold.

(b) Funds may move towards markets other than those of the reserve centre countries.

In either event it has to be considered whether these funds tend to move to countries with a balance-of-payments deficit or to those with a surplus. In the former case the funds would move in line with the dictates of logic and economic co-operation; an inflow of short-term money into such a country could, moreover, render it unnecessary for the country in question to make drawings on the I.M.F. In the second case an abnormal situation would be created in the country concerned and measures might have to be taken to neutralise or repulse the influx.

In attracting short-term funds — as in discouraging them — a leading rôle is played by the official discount rate, which seems, for psychological reasons and by virtue of its symbolical significance, to draw special attention to itself. Of course, if recourse is had to the discount rate solely with a view to the external effects likely to be produced, this may sometimes raise the problem of how to prevent repercussions on the internal economy. For example, a country with a balance-of-payments surplus (which nevertheless feels it necessary to pursue a policy of internal credit restraint, either because it wants in this way to curb an incipient boom or because its parliament wishes to pursue a policy of semi-austerity) should, according to the tenets of international co-operation (on the *surface*, of course), lower its official discount rate in order to discourage the inflow of funds from abroad (and possibly to encourage at the same time an outflow of domestic capital, should this be permitted by the existing legislation). In these circumstances, the country in question will have to resort to means other than the discount rate to reduce internal liquidity and to curb domestic credit expansion.

The opposite may occur in the case of a country which finds itself with an external deficit while its internal economy is in a state of recession or stagnation and requires stimulating by a lowering of the discount rate. In such a case, over and above the discount rate, an experiment could be made with a system of allowing preferential rates on foreign currency deposits. (Compare the practice generally adopted in England of allowing interest on sight deposits only if they are of foreign origin, or the recent decisions of the U.S. Administration with regard to the treatment and terms to be granted to official foreign balances). This does not give rise to two different types of money, depending on whether or not the funds in question

benefit from preferential interest rates; it serves rather to *encourage* foreign funds in much the same way as these may be *discouraged* in the reverse case. (Compare the practice obtaining at present in Switzerland, by which short-term foreign funds are penalised).

In cases of this kind it is a question, generally speaking, of applying what I have referred to elsewhere as the "system of the two-way cure" (18), by which I mean that, because any change in the discount rate has a global effect (both internal and external), it is necessary to administer an antidote in order to neutralise to the desired extent certain of its *internal* effects. It would also be possible, conversely, to apply an antidote to counteract only its *external* effects, but this does not fall within the scope of the present study, the aim of which is to examine the movements of short-term money and the harmonisation of discount rates. Let me, however, add in passing that certain arguments based on domestic requirements that have frequently been proffered by various countries in the past as a reason for declining to bring their discount rates into line with those of other countries would no longer hold water if a satisfactory system could be found of preventing the discount rate from having repercussions on the internal economy. In this way, with at least some of the prejudicial internal effects removed, co-operation would be easier to achieve and reasons for avoiding co-operation would become harder to find.

Of course, it is not possible to "insulate" the discount rate — i.e. to prevent it from affecting the internal economy — for long; the internal and external markets are interrelated, even under the system of limited external (i.e. non-resident) convertibility, as are, too, the market for short-term official funds and that for short-term private funds. It cannot, however, be denied that certain measures are *temporarily* effective, especially if they are applied with due regard to the prevailing circumstances (19). We are still, it should be recalled, dealing with a partial approach — with co-operation on the *surface*. And this leads me to stress once again that the need for a general and systematic examination of the central features,

(18) Cf. A. FERRARI: *Politica monetaria. Evoluzione e aspetti odierni*, Milan, 1959, pp. 131, 132, 136 and 163.

(19) For example, the payment of preferential rates on official funds alone presupposes a co-operative attitude on the part of central banks. And the allowing of interest on all sight funds in foreign currencies, as long as they are of foreign origin, would create certain difficulties for a country which had already reached the stage of full internal convertibility.

both external and internal, of the individual national economies is becoming more and more urgent.

But despite the basically partial nature of an approach in the form of co-operation on the surface as described above, it might nevertheless be worth while for central banks to adopt a common and far-sighted attitude with regard to international short-term funds, which are tending to move in increasingly tortuous circuits, one on top of the other. In so doing, central banks should themselves pay less attention to the attractiveness of interest-rate differentials, the better to discern the ultimate purpose of certain movements of funds. On the other hand, even the justification for moving short-term money wherever interest rates are most propitious, on the basis of the so-called "law of the market", is rather open to question; for there is no speculator who does not believe (or, at least, maintain) that he plays a useful rôle in quickening economic life. Let us not forget, however, that it was the wild movements of hot money and flight capital in the thirties that led to large-scale state intervention and control in the exchange field. Among the "blessings" of those days, too, we had competitive monetary devaluations. Let us beware today of competitive monetary revaluations... but to embark on this subject would make this talk too long!

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