Conversations on International Finance

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In the course of their duties, the officers in charge of foreign exchange operations of various central banks have many opportunities to exchange personal views on questions of mutual interest. Recently, Messrs. Coombs, Iklé, Ranalli, and Tüngeler —mindful that their views had coincided in a great many respects—undertook an experiment to set down on paper these mutual thoughts. The result was the following notes which are published here with the thought that they would be of interest to a wider public, particularly those concerned with international finance.

Since early 1961 the Bank of Italy, the German Federal Bank, the Swiss National Bank, and the Federal Reserve Bank of New York (as agent for both the United States Treasury and the Federal Reserve System) have been closely associated together with other central banks in various joint operations in the gold and foreign exchange markets. In our respective banks, we have been entrusted with the negotiation and conduct of these and other related operations and, in the process of almost daily consultation with one another, have found ourselves thinking along more or less similar lines. In the course of recent meetings in New York and Basle to deal with various operational problems, we have also reviewed our market experience of the past two years and have tested how far we could agree, as individuals, on some of the outlines of a possible pattern of operational policy for the future. We found such a substantial measure of agreement that we thought it might be useful to prepare a summary of our conversations.

SOME GENERAL CONCLUSIONS

First of all, it seems clear to us that the international financial system has demonstrated a high degree of flexibility and resilience in absorbing, during a period of recurrent pressure on both the dollar and sterling, the successive shocks of the German mark and the guilder revaluations, the Berlin crisis, the Canadian devaluation, world-wide stock market declines, the Cuban crisis, and, finally, the rejection of the British application for membership in the Common Market. These emergency situations were swiftly and effectively dealt with by cooperative action by the major central banks and treasuries on both sides of the Atlantic and by the International Monetary Fund. The informal arrangements for joint activity in the London gold market, central bank forward operations, provision of central bank credit facilities either on the "Basle" *ad hoc* basis or formalized through stand-by swap facilities, United States acquisition of foreign exchange and intervention in the exchange markets, massive Fund credits to the United Kingdom and Canada, and, most recently, United States Treasury issuance of certificates and bonds denominated in foreign currencies—all these have amply proved their usefulness in offsetting and restraining speculative pressures in a number of critical situations. Those who might be tempted to speculate against any major currency are now confronted with the prospect of coordinated defensive action by central banks, treasuries, and the International Monetary Fund. Through such cooperative arrangements, truly impressive resources can now be mobilized in support of any currency under attack.

There has been a tendency in certain quarters to regard these central bank and other intergovernmental defensive arrangements as no more than temporary and unreliable expedients. It is quite true, of course, that many of these defenses were quickly improvised, sometimes within a matter of hours, to deal with sudden emergencies. In most cases, they were negotiated on a bilateral basis and may give the impression of being no more than an unrelated patchwork. But these bilateral defenses have the most important advantage of being solidly based on market and institutional realities in each country and are capable of being flexibly adapted to new and unforeseeable needs. One cannot overemphasize the importance of being able to move quickly—on the basis of telephone consultations if necessary—against speculative pressures before they gain momentum. In our view, the central bank and intergovernmental defenses developed during the past two years should be regarded as a permanent reinforcement of the international financial machinery.

We are at the same time aware of doubts expressed by many important personalities in the universities and elsewhere whether such gradual adaptation and reinforcement of the international financial system will suffice to meet long-term liquidity needs. These doubts often seem to stem from the so-called "liquidity dilemma" which, in effect, suggests two highly undesirable alternatives: first, that the United States may continue to supply international liquidity through balance-of-payments deficits and, in so doing, progressively undermine the dollar until a collapse becomes inevitable; or, second, that the United States by balancing its accounts may thereby cut off the continuing flow of international liquidity upon which the secular growth of international trade and payments is alleged to depend. We have studied the various theoretical plans developed in an effort to find a solution to this liquidity dilemma and are inclined to think that the authors of these plans are asking many of the right questions, but so far suggesting unworkable solutions.

Quite clearly, the United States Government has given the only possible answer to one horn of the liquidity dilemma by asserting its firm determination to close the United States balance-of-payments deficit. Failure to do so would have disastrous consequences extending far into the future. While some progress toward reducing the deficit was made in 1961 and 1962, the time factor has now become a matter of major importance.

With respect to the second horn of the liquidity dilemma, that is, the alleged need for international liquidity to expand more or less in step with world trade and payments, the late Dr. Jacobsson cut through a lot of confused thinking on this matter:

> As trade increases—either domestic or foreign trade—enlarged credit facilities are required in national currencies to ensure adequate financing. Trade is of course financed in national currencies, and foreign trade is financed largely in the currencies of the main industrial countries. Thus an expansion in foreign trade is financed through the credit mechanism in individual countries. Under the old gold standard, the creation of credit in the various countries was closely linked to movements of gold, and in quite a number of countries, changes in the volume of credit have continued to depend to a large extent on changes in their balance of payments, as reflected in their monetary reserves. But despite this link, one should guard against implying that no increase in the credit volume can occur without an addition to monetary reserves. . . . The link is not absolute; there can be no question of any inherent parallelism between the expansion of credit and growth of reserves.

Similarly, the 1963 *Annual Report* (page 30) of the Bank for International Settlements has pointed out:

> One must be clear about the function of official liquid resources in the international payments system. These are not a circulating medium used to effect payment in day-to-day transactions, as the domestic money supply is used to settle internal transactions; the vast bulk of transactions is settled by offsetting sales and purchases on the foreign exchange markets, with the actual circulating medium coming from the domestic money supply. The use of foreign exchange resources is limited, therefore, to covering the differences that arise from time to time between the flows of receipts and payments. This means that there is no simple functional relation between the need for some aggregate of official liquid resources and the volume of world trade; in fact, it is the increased movement of short-term funds since convertibility that has required greater use of external liquidity rather than increased trade. Similarly, it may be readily seen by comparing the experience of various countries that there is no simple functional relation between the need for liquidity and any other statistical magnitude, such as the domestic money supply or total external transactions. This is because the need for liquidity is related to instability and the causes of instability are so varied and affect countries so differently that they cannot be expressed in a universal equation.

We are inclined to think that the problem of international liquidity is essentially a problem of dealing with the swings from surplus to deficit and back again by the major trading countries. While it would seem highly unlikely that the amplitude of these swings will increase in proportion to the growth of trade and investment, we would agree that some increase in the swings may well occur. But the problem of financing such broader swings would differ only in degree and not in its essential nature from the type of problem that we have been dealing with on the exchanges during the past two years.

At the 1962 meeting of the IMF and IBRD, Chancellor Maudling rightly asserted that reliance upon gold alone to provide for long-term liquidity needs was not an intellectually sustainable proposition. The Chancellor also warned that the expansion of the two reserve currencies —the dollar and sterling—was subject to limitations, which might consequently inhibit the growth of world trade and production. While we believe that the potential expansion of both gold and foreign exchange in official hands is considerably greater than is often supposed, more particularly if the United States were to supplement its gold stock by sizable holdings of foreign exchange, we would recognize the imprudence of exclusive reliance upon these sources of liquidity for an indefinite period of time to come.

Recognizing the possible long-term need for supplementing outright official holdings of gold and foreign exchange, we have considered various proposals designed to permit a continuing growth in foreign official holdings of dollars and sterling by equating these key currencies with gold through the medium of a gold guarantee. We would conclude that such "instant gold" proposals afford only illusory advantages. Such guarantees probably would not prove credible. But if such guarantees should even temporarily appear credible, and if the key currencies were thereby encouraged to expand their liabilities to third countries even more, this would result in a deterioration in the liquidity position of the key currency countries and progressively undermine the credibility of the gold guarantee. In effect, the key currencies cannot escape, and cannot by any device be rendered capable of escaping, the balance-of-payments disciplines that are the only real guarantor of a currency's stability.

Assuming that neither gold nor foreign exchange nor gold guarantee schemes can adequately provide for the long-term growth in liquidity that may be required, we can visualize no effective alternative but to rely upon a further development of mutual credit facilities among the major trading nations to cope with the inevitable swings in their payments accounts. Provision of medium-term credit facilities to supplement outright reserve holdings was, of course, precisely the purpose for which the International Monetary Fund was developed, and the borrowing arrangements negotiated in 1961 now enable the Fund to supply truly massive amounts of liquidity to any member country, including the United States.

At the short end of the credit facility spectrum, the Federal Reserve has negotiated during the past eighteen months an extensive network of swap arrangements with most of the major central banks on both sides of the Atlantic. Such stand-by swap facilities provide for virtually automatic access to credit up to specified amounts but, as has been repeatedly emphasized by the central banks concerned, they are primarily designed to deal with flows of funds expected to reverse themselves within a relatively short period of time.

What seemed to be lacking, however, was a type of medium-term credit facility in the, say, fifteen- to thirty-month maturity range, which might usefully be employed to deal with deficits and surpluses that were unlikely to reverse themselves within the short space of time appropriate to swap arrangements but were not so generalized as to suggest recourse to the Fund. In this connection, we have studied recent United States experiments with the issuance of special certificates and bonds denominated in foreign currencies, and are inclined to think that the use of such borrowing instruments might well be developed further. More particularly, insofar as such special certificates and bonds contain clauses assuring their liquidity in the event of need, they would open up an important new dimension of international liquidity.

We can visualize, therefore, in very rough outline, the consolidation of an international financial system which would provide four main sources of liquidity:

(a) Official holdings of gold and foreign exchange.

(b) Formal swap arrangements, or similar bilateral understandings on an informal basis.

(c) Issue of special certificates and bonds denominated in the currency of the creditor country.

(d) Access to the International Monetary Fund.

Such a system could provide for each country an appropriate blend of economic discipline and international credit. Short-run credit facilities would be largely automatic, while longer term credit requirements would necessitate either bilateral negotiations between the debtor and creditor country or negotiation between the debtor country and the International Monetary Fund. [In] the remainder of these notes, we summarize in somew[hat]

more detail our discussions on various specific aspects of each of the four sources of liquidity listed above.

SOURCES OF INTERNATIONAL LIQUIDITY

GOLD AND FOREIGN EXCHANGE: (a) *Gold.* The supply of newly mined and Russian gold reaching the market is now running at an annual rate of approximately $1.5 billion. Industrial uses of gold normally take up $400-500 million annually and, in recent years, much of the remaining supply has been absorbed by private speculative buying generated by international political tensions and the recurrent weakness of both the dollar and sterling.

The gold pool arrangements developed late in 1961 have greatly facilitated official control of the London gold market, and may increasingly have the effect of persuading potential gold speculators that the present official price of gold can and will be held. More fundamentally, the 1962 Cuban crisis may have marked a major turning point in international political relationships and opened up the prospect of a gradual relaxation of political tensions. If, in this context, the United States makes further appreciable progress toward closing its payments deficit, private demand for gold might well become largely limited to industrial and artistic needs. In turn, this might permit central bank and other official buyers to acquire a much larger share of newly mined and Russian gold. In view of the heavy expense being incurred by gold speculators in carrying the massive hoards acquired during recent years, it would not be surprising, in fact, to see a sizable volume of dishoarding, thereby increasing the supplies available for official use. Under the twin assumptions of both an easing of international political tensions and a strengthening of the dollar, the flow of newly mined and Russian gold might well augment official gold reserves at a rate of roughly 2 per cent per year, which would represent a very substantial contribution to the growth of international liquidity. The orderly distribution of such new gold among the various official buyers would be facilitated by continuance of the present gold pool arrangements.

(b) ***Foreign exchange.*** As previously noted, it is essential that the United States balance of payments be restored to equilibrium as soon as possible so as to curtail the flow of dollars to foreign central banks and thereby minimize further reductions in the United States gold stock. In this connection, however, it might be worthwhile considering whether the present balance-of-payments accounting system of the United States does not unduly magnify its deficit position. Thus, the United States does not net out the short-term claims of American banks against their short-term liabilities but, rather, takes into account only the change in gross short-term liabilities in calculating the balance-of-payments deficit or surplus. Since the gross short-term liabilities of the United States are convertible into gold if held by foreign central banks and, if in private hands, may readily be shifted to foreign official account, this accounting practice serves to focus attention upon the liquidity position of the United States, i.e., the volume of potential claims upon the gold stock. Until such time as the United States restores a solid equilibrium in its balance-of-payments accounts, it would probably be prudent to continue such accounting procedures. On the other hand, after an equilibrium in the United States payments position is restored, it might be worthwhile considering whether some, if not all, the short-term banking claims of the United States might not be offset against its short-term banking liabilities. As United States exports increase over the years, an increase in United States claims against foreigners through acceptance and other trade financing will be both natural and desirable. Conversely, with the continuing growth in world trade and payments, foreign commercial banks and private traders will probably wish to carry a gradually rising volume of dollar balances for financing trade and other current requirements. If through central bank cooperation and other means speculation can be kept under control, a statistical offsetting of such claims and liabilities resulting from trade financing might have considerable merit.

In 1961 the United States initiated a program of acquiring outright holdings of foreign exchange as a means both of defending the dollar and, over the long run, of contributing to international liquidity. This has been a truly revolutionary development which has added a new dimension to the international financial system and opened up a broad range of possibilities for further strengthening the international financial machinery. Mainly due to the continuation of United States payments deficits, the United States authorities have so far been able to acquire only limited amounts of foreign exchange, but encouraging results have nevertheless been obtained from moderate-scale intervention to support the dollar. As the United States accounts move closer to equilibrium or surplus, extensive scope for accumulation of foreign currencies will appear. Although the United States authorities will naturally wish to give careful consideration to the risk factor involved, it seems quite possible that the accumulation of foreign exchange balances by the United States may encounter two institutional limitations before the amounts held become so large as to suggest the existence of serious risks. The first limitation is that of short-

term investment facilities which in a number of European countries would at the present time be quite unable to accommodate a sizable accumulation of United States official funds. Sterling and the highly developed London money market are, of course, a major exception, and this in itself might suggest that the United States authorities might find it technically convenient to hold a sizable proportion of their foreign exchange in the form of sterling. Much will also depend upon the pace of development of the money and capital markets in Continental countries, with the possibility of United States official placements perhaps giving additional impetus to such a development. The institutional obstacles with respect to investment facilities do not lie entirely upon the European side, however, since the Federal Reserve finds itself constrained by law from placing any foreign exchange balances in foreign treasury bills.

The second major limitation on the accumulation of United States foreign currency balances is the fact that balances in one currency are not always fully useful for making payment to a third country. Thus, while the United States can readily shift from one European currency to another, either directly or through the market, such transfers result in parallel transfers of dollars, with the effect that the entire operation tends to become self-defeating. Some escape, however, from this perverse consequence of the use of the dollar as an international currency has been found in the swap of German marks for Swiss francs executed for United States Treasury account in December 1962 with the cooperation of the German Federal Bank, the BIS, and the Swiss National Bank. This technique is clearly capable of further useful development.

(c) ***Ratios of gold to foreign exchange.*** The gold ratios of the major central banks on both sides of the Atlantic vary widely. It seems to us questionable whether so divergent a ratio pattern will prove stable and, unless special arrangements can be made, one might expect to see a gradual upward drift of the lower ratios. Equalization of gold ratios at a very high level would represent, of course, a retreat from the gold exchange standard and a contraction of international liquidity.

To deal with this problem, we are inclined to suggest an evolutionary approach which should seek a gradual narrowing of the present spreads among gold ratios, first, by encouraging the fullest possible flow of newly mined and Russian gold to those low ratio countries that wish to raise their ratios and, second, by seeking somewhat greater flexibility in the gold policies of the high ratio countries. Such gold policy flexibility by the high ratio countries need not necessarily involve a permanent reduction of their ratios, perhaps no more than a willingness to take in for temporary periods somewhat larger foreign exchange balances. Alternatively, if they find it difficult to justify temporary bulges in official holdings of foreign exchange, the high ratio countries might examine ways and means of immunizing their official purchases of foreign exchange, during their periods of balance-of-payments surplus, by entering into swap or forward operations with their commercial banks—thereby encouraging the banks to hold the foreign exchange coming to them because of the country's surplus, instead of unloading it on the central bank.

Even if the present spread among reserve ratios were appreciably narrowed, however, there would remain the problem of the most appropriate mode of adjustment to flows of dollars between relatively low and relatively high gold ratio countries. Thus, a flow of dollars from Germany to Switzerland would create a potential drain upon the United States gold stock even though the American accounts were in balance at the time. As noted above, the surplus countries might temporarily cushion the adjustment process through some degree of flexibility in their gold ratio policies and through swap or forward operations with their commercial banks. If, on the other hand, a high gold ratio country continues to run persistent and sizable surpluses, the United States might find it appropriate to absorb part of the surplus dollar acquisitions of the creditor country by issuing special bonds denominated in the currency of the creditor. Such bonds, as will be outlined in more detail below, would provide an appropriate investment medium for such balance-of-payments surpluses.

CENTRAL BANK SWAP FACILITIES. During the past year there has gradually been created a network of swap arrangements amounting to more than $1.5 billion between the Federal Reserve on the one side and nearly all of the major European central banks, plus the Bank of Canada and the Bank for International Settlements, on the other. Initially, most of these swap arrangements provided for a basic $50 million credit line. The degree of flexibility as to amount is well illustrated, however, by the execution of a United States-Canadian swap in the amount of $250 million during the Canadian dollar crisis, two Swiss franc swaps totaling $200 million which were arranged to take care of speculative pressures arising out of the stock market decline, the increases of the Bank of Italy and German Federal Bank swaps to $150 million each, the increase from $50 million to $100 million in the swap line with the Bank of France, and finally the increase of the Bank of England swap line to $500 million. Thus

reinforced, the swap network now constitutes a first line of defense capable of withstanding the most severe speculative challenges. Even more important, the very existence of the swap network tends to suppress the growth of speculation at its source by providing convincing evidence of central bank determination to maintain the existing network of gold and exchange parities.

Whether other central banks will choose to take the initiative, as has the Federal Reserve, in negotiating a similar network of swap facilities, remains to be seen. What is far more important is the spontaneous and understanding concern of the entire central banking community for any member central bank subjected to speculative pressure. The "Basle" credits of more than $900 million extended by European central banks to the Bank of England during the sterling crisis of 1961 provided a dramatic example of the ability and readiness of central banks to spring to the defense of a currency under attack. More recently, in February-March 1963, the provision of $250 million in short-term credits to the Bank of England by several Continental central banks helped to nip in the bud another speculative attack on sterling.

Central bank swaps and other credit facilities are, by their nature, essentially short term, and use of such facilities should accordingly be limited to situations in which the flow of funds is expected to be reversible within a relatively short period of time. In various operations during the past two years, the Bank of England, the Bank of Canada, the Federal Reserve, and other central banks involved have closely adhered to this principle. Quite clearly, however, it will not always be possible for a central bank to make an accurate diagnosis of payments trends. What initially appears to be a temporarily adverse swing may turn out to be rooted in an underlying disequilibrium requiring time-consuming corrective measures. In such circumstances, reliance on central bank swaps to bridge a protracted deficit would involve repeated roll-overs of short-term credits with potentially embarrassing consequences for both central banks concerned. In such circumstances, medium-term financing should be substituted for central bank swaps. The British shift from the "Basle" short-term credits to medium-term financing by the International Monetary Fund is an illustrative case in point, while in other situations a shift from central bank swaps to intergovernmental financing at medium term might be more appropriate. The risk that a central bank may become so deeply involved in short-term borrowings as to make necessary recourse by its government to drawings upon the Fund or other medium-term credit facilities points up the desirability of a full exchange of information on swap and similar credit operations among the cooperating central banks on both sides of the Atlantic.

SPECIAL CERTIFICATES AND BONDS. As previously noted, some form of medium-term credit should be substituted for swap credits which cannot be liquidated through an early reversal in the flow of funds. In cases where that likelihood can be foreseen, medium-term credits should be arranged from the beginning. For certain countries, and in certain circumstances, recourse to the Fund will prove to be the most appropriate course of action. In other contexts, however, bilateral arrangements between the creditor and debtor countries concerned may well be deemed preferable. After the last war, direct governmental loans by the United States to various European countries, of which some $6 billion remain outstanding, provided such an alternative to drawings upon the Fund, and there is no reason why the United States, when confronted with stubborn deficits of its own, should not seek to arrange similar medium-term credit facilities on a bilateral basis with the surplus countries.

Precisely such a bilateral medium-term credit arrangement did in fact arise out of the strong surplus position of Italy during 1962 and the resultant heavy accumulation of dollars by the Italian Exchange Office. Early in the year, both Italian and United States officials recognized the probability that the flow of funds to Italy was likely to continue for a good many months to come, and accordingly no effort was made to deal with the situation through central bank swap arrangements. Instead, the United States Treasury proceeded to absorb the flow of dollars to Italy through issuance of three months' certificates denominated in Italian lire. After several renewals of such certificates in the face of continuing surpluses in the Italian accounts, the United States Treasury and the Bank of Italy agreed to fund the certificates into fifteen-month bonds, thereby explicitly and publicly recognizing the need for such medium-term financing.

By taking into its portfolio such medium-term bonds, the Bank of Italy provided effective financing of the Italian surplus in 1962 through a flow of official investment funds to the United States. This technique of medium-term foreign investment by creditor central banks in bonds denominated in their own currency need not necessarily be confined to the financing of current surpluses, but might also be employed *ex post* to consolidate part of earlier surpluses which have meanwhile been placed in short-term earning assets abroad. Thus, it has proved advantageous for the United States Treasury and German Federal Bank to fund a certain amount of the current dollar reserves of the German Federal Bank into medium-term mark obligations. In view of certain technical obstacles

effectively limiting the maturity of the German Federal Bank's assets to no more than ninety days, such medium-term German mark bonds carry a conversion privilege into ninety-day certificates on the implicit understanding that such conversions would not be made except under conditions of heavy drains upon the German Federal Bank's reserves, in which event the United States would also find it appropriate to prepay such debt. From the German point of view, these bonds thus fully retain their usefulness as a sound financial instrument buttressing international liquidity. Such a substitution of medium-term mark bonds for short-term dollar assets held by the German Federal Bank has had the further collateral advantage of improving the bank's gold ratio.

A similar conversion privilege was subsequently extended to the Italian lira bonds issued to the Bank of Italy in 1962. Convertible bonds denominated in Belgian francs and Austrian schillings have also been issued to the National Bank of Belgium and the National Bank of Austria in order to absorb surplus dollars accumulated by these central banks.

The usefulness of such issues of special bonds and certificates need not be limited to the financing by the surplus countries of bilateral deficits incurred by the United States. In actual fact, of course, the surpluses of most European countries reflect an over-all creditor position vis-à-vis not only the United States but many other countries as well. Even after the United States has regained equilibrium in its payments accounts, certain countries will from time to time move into a strong creditor position which will, in turn, expose the United States, as banker for the international financial system, to the risk of net drains upon its gold stock. We have previously suggested that informal understandings should be sought whereby the creditor countries might attempt, either through greater flexibility in their gold policy or through more extensive use of forward exchange and related operations, to avoid causing a net drain upon the United States gold stock. To round out such a system of minimizing net losses of gold by the United States as a result of pronounced surplus and deficit positions in other countries, the United States might also find it useful on occasion to provide the creditor country with an investment outlet for its surplus in the form of special bonds denominated in the creditor's currency.

Still another useful role for these special bond and certificate issues is illustrated by the recent United States Treasury arrangements with the Swiss Confederation and the Swiss National Bank. The Swiss Confederation for several years past has been running sizable budget surpluses and has thus been desirous of investing such savings drawn from the Swiss public. Initially these Confederation investments were largely placed abroad in short-term instruments such as United States Treasury bills. The Confederation naturally sought forward cover on such investments and, in the process, found itself competing in the forward market with the Swiss commercial banks and other private investors. To relieve this and other pressures on the forward rate, the United States Treasury began in 1961 a program of offering forward Swiss francs on the market, with the result that a sizable volume of forward contracts was taken up by the Swiss Confederation. Since the Swiss Confederation wished to stay more or less fully invested, repeated roll-overs of forward contracts by the United States Treasury to facilitate this investment were eventually recognized as an unnecessary complication. The decision was accordingly reached to provide an investment outlet for the Swiss Confederation in the form of Swiss franc bonds, thereby enabling the Confederation to avoid recourse to the exchange markets and lessening the risk that Confederation investment operations might become confused with other Treasury and Federal Reserve exchange operations.

A second operation involved the issuance by the United States Treasury to the Swiss National Bank of eight-month Swiss franc certificates (subsequently funded into medium-term bonds) which are convertible into ninety-day certificates. These issues were designed to afford an investment outlet for funds previously drawn by the Swiss Confederation from the commercial banks through the issue of so-called "sterilization rescriptions" and hitherto retained unused in a special account at the Swiss National Bank. The Swiss franc proceeds thus acquired by the United States Treasury at a relatively favorable rate of interest may be employed for purposes of exchange market intervention or for conversion into gold at a fixed price on demand. Quite aside from the possibility thus afforded the United States Treasury of supplementing its gold resources, on a temporary basis, the operation provides confirmation of the fact that, in individual instances, arrangements that embody an exchange guarantee are capable of doing all that could be expected from a gold guarantee, with none of the complications involved in the latter procedure. In effect, Switzerland is prepared to sell gold to the United States against payment in a Swiss franc security.

We are inclined to recommend further careful exploration of the potentialities of such special certificates and bonds which might conceivably grow into a second line of defense behind the swap network.

THE INTERNATIONAL MONETARY FUND. The Fund constitutes in many respects the ultimate liquidity resource of

the international financial system. IMF quotas are an effective addition to international liquidity, and these resources are capable of further expansion. Substantial parts of each country's quota can readily become part of its reserves when it runs deficits, and the entire quota can become available, as has been shown in several important cases. We do not feel ourselves competent to make any judgment on the profound policy questions involved in more or less automaticity in Fund drawings, but we feel confident that an appropriate blending of automaticity and discipline will in time be achieved. In any event, the swap network and the possibility of broader use of bilateral credits through issuance of special certificates and bonds can provide a most useful supplement to the Fund's activities.

In fact, there is no need to expect, or to seek to achieve, a uniform path along which debtor and creditor countries move as they receive or grant credits in the course of payments swings. For some countries, the IMF is and will continue to be virtually a first line of defense, while others may prefer to reserve its use for more protracted and generalized deficits. Whichever course may be taken, however, the very existence of the Fund and of its large resources will provide to all member countries continuing assurance of the type of international monetary cooperation that the Fund symbolizes and embodies.