ESSAYS IN INTERNATIONAL FINANCE

No. 54, May 1966

RESERVES, RESERVE CURRENCIES, AND VEHICLE CURRENCIES: AN ARGUMENT

ROBERT V. ROOSA AND FRED HIRSCH

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DEPARTMENT OF ECONOMICS
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This is the fifty-fourth in the series ESSAYS IN INTERNATIONAL FINANCE *published from time to time by the International Finance Section of the Department of Economics in Princeton University.*

As in the case of Essay No. 47, this is not an essay, strictly speaking. Rather, it takes the form of a dialogue, reproducing a discussion held by Robert V. Roosa and Fred Hirsch in London on January 28, 1966.

Robert V. Roosa is now a partner of Brown Brothers, Harriman and Co., Bankers. He has served in several financial positions in the U.S. Government, including Vice President of the Federal Reserve Bank of New York and Under Secretary of the Treasury for Monetary Affairs in the Kennedy and Johnson Administrations. His published works include MONETARY REFORM FOR THE WORLD ECONOMY, *1965.*

Fred Hirsch is an Assistant Editor of THE ECONOMIST, *and his views on international monetary questions are often expressed in the pages of that weekly. He has also written numerous signed articles in other financial journals. He too published a book in 1965,* THE POUND STERLING: A POLEMIC.

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International Finance Section

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HIRSCH

Dr. Roosa, one could regard you in a sense as the architect of the whole system of attempting to deal with international currency problems on an *ad hoc* basis. You successfully used your influence in the Kennedy Administration, when it came in, not to go even for a scaled-down version of something like the Triffin Plan, but rather to build up your piecemeal defenses in various ways. One wonders how you feel about that in hindsight from your present nonofficial position. Do you have any regrets about this; do you think it might have worked to have gone for something bigger then?

ROOSA

No, I am just stubborn enough to think even now that this was the better approach for that time. I would not want, however, to leave the impression that I was the architect. I happened to sit where the thoughts and capabilities of a lot of other people could be brought together. At that point I did have an opportunity to form my own judgment as to how real progress could develop. It was my view that major change in the liquidity arrangements of the world would depend upon experience gained from a series of new methods to be introduced step by step. This would also, or could also, bring an evolutionary change in the states of mind of those people who, whatever happens, are going to be the principal monetary authorities in the various countries, not only in the leading countries, but also in the less developed.

From the beginning, in the Kennedy Administration, we stressed that our own position was going to be essentially as you have described it. We began by taking two major steps that we thought were the most critical at that stage: first, the introduction of what we called the "ring of swaps," bilateral arrangements with a number of central banks of other countries; and, second, developing enough agreement among most of these same countries to provide for the establishment of the General Arrangements to Borrow in connection with the International Monetary Fund.

We thought of these, both for the world payments system and of course for ourselves, as defensive mechanisms that would meet the most pressing risks of the moment. We thought they also combined within them the opportunity for bringing about a kind of common experience, a common approach that would be the basis for more ambitious efforts later on. We also thought that it was better to wait for the introduction of any more major and lasting substantive changes of a structural kind until the immediate strains of those earlier years in the payments positions of the United Kingdom and the United States had at least been temporarily surmounted or, hopefully, overcome.

HIRSCH

Have you any reaction to Arthur Schlesinger's reported comment that you rather enjoyed walking the tightrope?

ROOSA

I have not seen the comment, I am sorry to say. I intend to learn all I can about those days from reading the books that are now available and so well written. But if that is what he said, I suppose I should agree that, without enjoying this in any gleeful or reckless sense, I did feel that it was essential to develop friendly, harmonious working relations as a basis for the international financial cooperation that we were going to need more and more in future years. I deeply felt that this could only be built in ways that did require a kind of personal involvement of the officials on all sides and one that gave them all a sense of participating in a successful kind of experiment. In that, there was a kind of enjoyment for all of us. To turn that around, I think it was important to remove the impression that we were desperate defenders of a beleaguered position, and to let us realize that, whatever might be the defensive aspects of this, we were really sharing in an opportunity to test out some of the building blocks for what could eventually be a major creative effort.

HIRSCH

Yes, quite. You are saying, as I understand it, that one had to go slow at the beginning. One had to build up what one had in international cooperation in order to advance to more radical schemes later on. Now I could follow you in this if no country were officially pressing for radical reform, if all were agreed on the inevitability of gradualness. Yet this has not been so in one of the key disputes of the past three years—the dispute between the Anglo-Saxons and the Continentals on the role of the reserve currencies. Here the Continentals are radicals: they would be rather better disposed toward certain elements of the Triffin scheme than they are to the building up of the *ad-hockery*. This is the basic French attack on the privileged position of the dollar or, in a different form, on the irrational elements in present reserve creation, depending as it does very largely on the particular deficits of the United States. In this matter of diagnosis, as a lot of people have said, even the Rueffian position is, ironically, rather similar to Triffin's. So, was not the American refusal to throw the position of the dollar under scrutiny a *handicap* to the emergence of a real international consensus on the road to reform? And is that not at the present moment one of the factors that is making it difficult to get a reform that is worth having?

ROOSA

Part of our reason for going slow, behind or surrounding the various reasons I have already given, was that we felt, and I still do feel, that there is no single clear pattern yet visible for any ultimate answer. We wanted to learn something more from experimentation before we had to reach the stage of taking a full commitment in any one single direction. And in thinking of a full commitment, probably the greatest single change that the United States could ever be involved in, as the whole system is being reappraised, would be a decision to give up the burdens and responsibilities that go with any of the gains of being a reserve-currency country.

We were very mindful of the responsibility side of this. We were concerned over what would happen to the normal and existing patterns of payments and of reserve transactions if the United States were even to cast a shadow of doubt over our current readiness to continue the servicing role we have performed for so long. What would happen to the whole pattern of prevailing world trade and capital movements? We felt it was prudent for us and helpful to everyone else to avoid any action that would impair at that time the continued functioning of the monetary system, centered on reserve currencies and buttressed by the Monetary Fund, as it then was. Any such impairment, we felt, would be throwing too much on one possible path of further evolution before we had had the experience to be certain which way to move. I think, in that vein, we are still learning.

I would not agree with some of the things you have written implying that there is no necessary connection between the functioning of a currency as a vehicle or trading currency and its serving as a reserve currency. Mind you, in diagrammatic logic it is possible to show them quite separately. And through gradual changes over time—and here I mean decades, not merely months—it may turn out that a currency can fulfill the basic trading requirements that a growing world economy needs without also serving as a reserve currency. But I am still very fearful that a deliberate cutting of that link would actually impair the performance of both functions. This seems to me true for the dollar at least; I hesitate to speak for sterling. The function of the dollar as a trading currency would be impaired if the option of its use as a reserve currency were to be denied or denigrated.

Here is where I find the greatest difference from some of the views expressed by some Continentals. I have no objection at all to visualizing an evolution of the system in which there would be no enlargement in the supply of dollars serving as a reserve currency. But there is a great difference between having that occur as a byproduct of other changes and having it imposed as a precondition for such changes. Money rests so much on confidence—confidence in all kinds of countries and among all kinds of people. That is why I feel that the generation of acceptable, and continually acceptable, international monetary claims is one of the most awesome prospects ever contemplated for the joint action of nations. We have to be reasonably sure to create an environment in which this can move forward for a while experimentally before we cut off the other elements on which we have previously been dependent.

What I object to is starting a new arrangement with the commitment that dollars must be removed from official reserves. I do not at all rule out the possibility that we may very well find, and I hope we will find, that the role of the dollar as a reserve currency diminishes as a result of the actions that evolve; not because it has been forced on us.

HIRSCH

I am very glad to hear you put it in this way, that you hope that the role of the dollar as a reserve currency will diminish. Certainly, I would totally agree with you in rejecting some of the more extreme Continental notions that one should lay down hard and fast rules about this, and that one should bar people from holding certain forms of money. The one thing we have learned in the whole history of money is that money is what people like to hold. So that it is absurd, domestically and internationally, to say that they must not hold this or that as a monetary claim. But might I take you up on this connection, which is of real practical importance, between the reserve-currency function and your vehicle-currency function?

If one takes sterling, the general position has been that the reserve-currency function, measured by the total balances in external official hands, was mainly built up during the war, and has not really moved much since; since then one has just had the overhang. Having that very large overhang of official liabilities has unquestionably been a factor in the vulnerability of sterling. And that vulnerability of sterling, at least since 1957, has quite clearly cut down the private commercial use of sterling, its use as a vehicle currency. In 1957, there was a general curb on foreign overdraft credits during that crisis; world traders turned to Euro-dollar financing as an alternative. More recently, we had a great tightening up on long-term financing, even in financing of foreign firms that are actually in Britain.

In the case of the dollar, you had in mid-1963, as a result of similar pressure then, the interest-equalization tax greatly cutting down the use of the dollar in New York issues. This has since been extended to some bank loans; and you have had non-tax, voluntary restrictions on the extension of external bank loans as a whole. Now this is where Triffin argues—and personally I do not see any flaw in the argument—that in this sense the function of a currency as a reserve currency, producing the overhang of these official liabilities, actually impedes the private-financing function. How do you see that?

ROOSA

No, I would not accept it. My own feeling is that the reserve-currency role, despite its many problems for us, has been an integral part of the trading-currency role. The separation would be as delicate as operating on Siamese twins. As for these more recent developments, I think that the restrictions that the United States has imposed, and perhaps many that the United Kingdom has imposed—although I cannot be as sure of this—were largely the result of the failure of our own economies to accomplish adequately and soon enough the other parts of the overall adjustment process that would confront any country in our general economic circumstances, whether or not such a country had a reserve-currency role. I also do think it is true that the uses that we, at least in the United States, made of our reserve-currency position were in some measure abuses. I doubt if that would ever happen again. We were going through the first period, for the United States, in which the great capacity of the world for utilizing reserves was being in some measure (I would not say wholly, by any means) overused by the United States. Our own deficits were running too large for too long. From that side, I would say that much of the European criticism has a grain of truth in it.

I do not believe that this is an inherent characteristic of a reserve currency, certainly not a currency that is now, after a few years' experience in this, subject to a multilateral surveillance that will reinforce our own resolve to keep our overall accounts in reasonable balance. Moreover, the developments that necessitated temporary resort to restraints on the flow of capital were not in our case unique characteristics of a reserve currency. I think perhaps some of the same difficulties that we are mentioning here in terms of impairing the use of the currencies would have occurred in any case because of our own size and the complexity of our trade and payments relations with the rest of the world. They occurred because our external-payments positions were weak and had been weak for some time, not necessarily because there had been a significant outstanding overhang of sterling balances or dollar balances.

HIRSCH

But the overhang does make it worse, would you not accept that? The overhang makes you that much more vulnerable to private-banking claims than if you do not have an overhang.

ROOSA

Well, let me ask you a question: where is the overhang? Which of the present sterling balances would you think you could reach with an effort to consolidate, and, if you reached them, what gain do you think you would have? Whose balances are these that are causing this further aggravation of a problem—which might be explained on the ground that I have already suggested?

HIRSCH

Well, put that way, you never can tell. You can never identify the potentially troublesome balances in advance, any more than you can ever identify in advance which particular banking depositor is going to rush to the door first. You can not tell; all you can say is that there are these nervous banking depositors and at any given time they are in danger of all storming the door at once. And the very fact that they are in danger of all storming the door, even if they do not actually get there, worries other people, and adds to the trouble of the situation. This is not fancy; it is very recent London history. Therefore, what I think one must do is have an open-ended possibility for any of these banking depositors, the official holders of reserve currencies, to transfer their reserve-currency claims into something like an IMF deposit. Personally, I would make this entirely voluntary and open-ended; and in that way, to use your terms, create a self-qualifying situation. If it is the case that none of your official holders, in practice, are troublesome holders, and if it is the case that they do not want to shift their funds at a time when they fear for the currency—well then you will not get any transfer of sterling claims into the IMF.

There is no difficulty in seeing from official U.K. figures that reserve-sterling countries *have* been shifting out of sterling at awkward times—admittedly still on a pretty small scale. But to say that the overseas sterling-area balances add to sterling's burden does not rest on these actual switches taking place on any large scale. It must surely be the case, almost as a matter of sheer mathematics, that the more claims you have on a bank with a given cash reserve, the more vulnerable it becomes to the acceptance of any additional claims.

I think the key point is really the following—and in a sense I feel that, over the years and especially now, you are maybe shifting slightly towards this position: There is now widespread agreement that the reserve-currency function, which after all is simply a means of transferring international debts through paper claims, is a function the IMF or some such body could perform, once you had sufficient trust. But the other function, of supplying and putting money into the international bond market or supplying a short-term trading credit, is one the IMF cannot perform. And therefore, if we are working on a limited cash position—very tenuous for the United Kingdom, less tenuous but still limited for the United States—then it seems to me that it is highly important to arrange for a shift-over of the official function as quickly as we can, just in order to safeguard this private function; because, as we see at this moment, it is on this "private international bond market" side that we are getting the real liquidity squeeze now.

ROOSA

Yes, I would agree—with qualifications. Certainly there must be a point at which the supply of either sterling or dollars can become too large to be compatible with its continued functioning as both a reserve and a trading currency; and that definition of too large is determined by the behavior of those who hold the currency. Speaking broadly, I think the present supplies of sterling or dollars are not too large—do not contain any distinguishable overhang—under ordinary conditions.

But I think that there is another source of vulnerability, that will exist no matter how we rearrange this system, and this is the crucial one. Surely there are times when—regardless of the general stability of the existing outstanding volume of funds of both kinds—conditions of panic, fear, excitement, concern, and agitation, will be created through some outside cause. Such conditions lead to a run from all currencies, with a convergence of pressures on those trading currencies which serve as a common denominator for transactions in all the others. It is at such times that you get a shift from one form of trading currency to another, or from one form of reserve asset to another. This is what

I call the risks of coexistence; they are always going to continue; and, therefore, we are going to have to find ways of minimizing their impact. They are necessarily inherent in having internationally acceptable trading currencies that must be interchangeable or redeemable in one or more forms of reserve assets.

I do not just want to play with semantics here, because I am basically agreeing with you that there is a limit. I question whether in the case either of sterling or the dollar now there is any calculable or discernible overhang, in the normal day-to-day affairs, of sufficient significance to be a major influence on the current performance of either currency. Now you would disagree; but I would say that the essential thing at this stage, when the world still needs these currencies performing as well as they can in both roles, is to avoid actions which seem inherently designed to create a presumption for holders of sterling or dollars that they have acquired a kind of second-class asset—that the monetary authorities, therefore, are finding a way for these currencies always to be shunted aside.

I also think that until we have reached the stage of introducing, with adequate safeguards, universally acceptable new international monetary-reserve assets, an approach toward resolving this supposed overhang problem runs a risk (if your view is accepted, and I do not myself concede the need) and raises another kind of question. For, in effect, you are proposing an open-ended facility through which holders of sterling or dollars, whenever they think they have too many, can unload them on some multinational facility supported by others. Will that not, at the least, cast new grave doubt on the readiness of the two countries issuing these currencies to take the steps necessary to maintain their own strength? Do we really want, could we ever expect to get, that kind of blank check?

HIRSCH

But the transfer would involve an eventual repayment obligation by America or Britain to the Fund, though these obligations must not be set on a rigid or inflexible schedule. Might I just put this specific point to you? Supposing the Continentals declared here and now that in relation to the new unit of reserves now being discussed, they would agree that it should be possible to establish such units as IMF deposits, by the transfer of officially held sterling or dollar balances; and supposing they proposed this without any highly constrictive arrangements on repayment by Britain and America, that is, permitting, say, repayment from the proceeds of future surpluses, as I know the Italians had in mind. How would you personally react to such a proposal? Would you think that this would be the time to take it up?

ROOSA

No, I can be consistent on that score. I would, as you know, have opposed it in 1961 or 1962. I would still oppose it, because I feel that the next major step in monetary reform must be one that adds to the joint and mutual responsibility of the European countries with us, in an orderly and determined way. I do not want undue privileges for us, nor an arrangement which offers any one monetary authority the privilege of "dumping" dollars into a pool financed by all the others.

HIRSCH

I am not certain that I quite follow that. The countries that will do the financing, if any extra financing is needed as a result of additional claims for other, scarce currencies in the IMF, will be the surplus countries, and I know of no system where it is otherwise. Ideally, there would be no "pool" that required financing: the IMF deposits would be the accepted medium of international settlement. I am also rather uncertain whether you see the reserve-currency role as a burden or as a privilege. Sometimes you rather imply that it is both.

ROOSA

Yes, let me just say a word about that. I have just reread some comments that you wrote in *The Banker* a little while ago in which you questioned this, and I would like to try to make a little clearer my feeling that the reserve-currency role is both a burden and a privilege.

You suggest there that the United States, after all, has been able to gain a great deal of extra financing and to keep a very large gold reserve that otherwise would have been paid out, given its large deficits, if the dollar had not been a reserve currency. That is true. But the pressure that we have had in the United States, in terms of achieving correction of the imbalance of payments, has in itself been passing through two phases. It is quite true that in the early stages we avoided gold outflows, we were able to improvise other things that minimized gold outflows, because countries were so dependent on the use of the dollar as a reserve currency that they wanted to cooperate in maintaining the gold reserve that helped (in the way that gold reserves do) to lend additional credibility to the currency itself for all the purposes it serves. But as the deficits continued, and continued large, for a variety of changing reasons, the position shifted the other way. We entered a second phase where the current accrual of dollars arising from the current deficits, superimposed on the already large outstanding dollar balances, led to the mounting up of both criticisms and pressures which became very articulate as additional influences in convincing the American authorities of the absolute need for taking determined action—adjusting our own payments position in a variety of ways.

In some ways, when the impact of outside criticism finally came through, it was more powerful than anything that a nonreserve currency could have experienced. In what I am saying I may have seemed to imply that I believe more in your overhang thesis than I conceded a minute ago, but I think with great effort I might make myself consistent.

On the side of burdens, furthermore, remember that the United States was never able from the beginning to contemplate the kind of drastic one-time, short-period, swift adjustment that is available to any other country, because we had to be mindful of the great dislocation this would have created around the world.

HIRSCH

You are referring to devaluation there?

ROOSA

No, I am referring to high interest rates. Our decision was most explicit in connection with President Kennedy's first balance-of-payments message, February 6, 1961. We had private word from representatives of several key countries to the effect that the hints raised there of special interest-rate action to defend the balance of payments of the United States would be totally disruptive to their own current positions. We were strongly requested to bear this in mind. Of course we were not unaware of this potential. We had deliberately, I can say now, made some of our statements in an ambiguous form in order to elicit response, to try to learn in that way, and we got our responses promptly.

The lesson of that was only one of several ways in which it became clear to us that, despite the urgings of our own banking community, and despite the public comments of some abroad who had counselled us quite differently in private, it was not going to be possible to take the risk of a short-lived, drastic, high-interest-rate policy. We did believe, some of us, that there need not have been impairment of the domestic economy from such a policy, for a short time, if it could have been accompanied quickly by the initial action on tax reform and tax reduction which we also contemplated with a view to generating an expansion of the domestic economy. It would have been risky, to be sure, but the overriding factor certainly in my mind, as a participant in the policy debate, was in favor of pursuing only the gradual pattern of change in interest rates that later did evolve. Our responsibility as a reserve-currency country did not permit us to dare create the unpredictable array of successive actions that would have followed from the swirling around of funds across the world as the result of a steep and long rise of U.S. interest rates at that time. We certainly did feel that this would have particularly hit the United Kingdom.

HIRSCH

Yes, but was this very commendable concern really based on the position of the United States as a reserve-currency country; or was it not merely a reflection of the sheer commercial size of the United States?

ROOSA

That is a good question and I do not know the answer. It was certainly in large part both. We did feel, though—and this is where I meant to imply that there is some inconsistency with my response on the overhang point—there was a large volume of funds, particularly in private hands as contrasted with official hands, a volume of funds that could in some measure (actually in amounts that could reach billions) have moved in response to decisive increases in interest rates in the United States. You would, I think, be surprised and impressed if I were to mention only a few of the names of people who spoke to me directly about moving balances in the United Kingdom to the United States if our rates could be 1 or 1½ per cent higher at that time. The totals would have been large enough to have turned the U.K. payments position around.

The same limitation on our freedom of action, of course in another way, was evidenced—and this is again special and it shows how you cannot really disentangle these things—when we announced the interest-equalization tax and Canada had monetary chaos. That was even more the result of our closely interrelated capital markets, to be sure, but those in turn had acquired a special character because the Canadian economy had for so long relied heavily on the dollar in its reserves rather than on gold.

HIRSCH

I would still see all this as the dire effects that follow from the restriction of the use of the dollar as a financing currency and a vehicle currency, rather than as a reserve currency. Its use as a reserve currency here, surely, just gives Canada an extra leverage. But can I take you up on your earlier objection to the transfer of dollars or sterling into IMF deposits? You implied that this would be a privilege—an unjustified privilege to the Continental countries. I do not quite follow this. Privilege in what sense? Most people, I think, would see it as morally neutral, so to speak: if they do not wish to keep their reserves in the form they are in now, and if they are prepared to move to a position that I think you have implicitly agreed would be a long-run rational position, of holding reserves in internationally issued paper, what is unreasonable about that? You were earlier saying that this was only possible once everybody had agreed to it. But if they request it, you say it is an unreasonable privilege!

ROOSA

I probably should not have used the word "privilege." It conveys too much. I rather mean an additional option which I think may take, under some circumstances, the form of being exercised as a privilege. But it is better to refer to it as giving the countries an additional option in the ranges of choice for the use of their own reserves. And I would say this: Once the opportunity exists for a country holding dollars (and I shall use that as the only illustration here) to shift them into the Monetary Fund whenever an unsettling event occurs—an event that may have no necessary bearing on the performance of the United States—it is a reflection of unsettlement in the monetary system that these shifts would be made into the Fund. And, as one leading country takes the step, its example might well be followed by another.

The tendency among governments, as among people, is sometimes to follow the leader. You would then find developing, so far as the dollar is concerned, a general cumulative questioning and doubt. I am quite certain that after the first few had made some transfers, sending out this kind of official signal that the alarm being feared is now confirmed, there would be heavy claims for conversion of dollars into gold. You would have built up, from the dollar's point of view, an additional mechanism of signalling, and an accelerator, for adding pressures upon the dollar's normal performance of its necessary role, when we do not yet have in the world an acceptable arrangement for providing another supplement to gold.

HIRSCH

Well, this would be the supplement, would it not?

ROOSA

No. As I see it, the difficulty is this. No supplement is adequate until the claims it creates are freely transferable claims, widely acceptable, among monetary authorities. You need all the conditions of the sort that I have put around my own version of the CRU. Short of that, I think, for more reasons than I had better take time to discuss now, you have a second-class asset. It is an asset which can be sought in moments of unrest as a possible refuge for a time, but I think it will not serve as a full-scale alternative to gold-holding unless we get all the other conditions that we have tried to prescribe for the CRU.

Once we get a CRU, I think that will do it. Gradually brought into place, as I think it can be, it could give us the prospect that eventually the scale of the use of dollars as a reserve currency will diminish proportionately. Whether the amount of dollars in use as reserves shrinks below the present level, or not, the proportion of dollars in total reserves will certainly shrink. Then we will find that the coexistence problem is taken care of, because all dollar holdings that are held for reserve purposes will reflect the firm wish of the official holder to maintain these as a kind of transactions balance, supporting his foreseeable requirements for maintaining his own currency in the exchange market.

HIRSCH

It seems to me now that your position is very similar to what mine would be for the present time; and similar too for the distant future; but the dispute is really on the intermediate position.

ROOSA

Yes.

HIRSCH

But does one not then have to face this practical matter? You point to the contingent danger that official transfers of this kind out of the dollar into an IMF deposit might worry other dollar holders, and so be disturbing. But is not the immediate question whether such transfers would prove *more* worrying and disturbing than what the industrial countries are doing at the moment, which is to transfer out of dollars into gold? The scale of the movements that were started by France, but followed by many other countries a year ago, has been quite considerable. I would have thought, given this quite marked official conversion of currency into gold that has resulted in a net reduction in international gold and currency reserves in 1965, given the scale of that movement, I should have thought that, if one had the opportunity to move the other way, out of dollars into IMF paper, that would be the smaller danger.

ROOSA

In the conditions of 1965, oddly enough, that did happen. And it was a possibility. That is, gold and dollar reserves, overall, shrank, while claims on the Fund rose by an almost corresponding amount.

HIRSCH

Thanks to the U.K. deficit!

ROOSA

Yes, the U.K. deficit took care of that and so, as a matter of principle in terms of the IMF as an alternative, I cannot disagree with you. I do think though that, to the extent new claims on the Fund are likely to be necessary, even though there is not another U.K. deficit, the financing through GAB (General Arrangements to Borrow) call-ups, and so on, provides adequately for the kind of outlet you are thinking of in the present setting without creating any additional unrest. But this is difficult, debatable.

Even though this may seem to make me agree with the logic of your position, I would rather concentrate now on what I think is more important in terms of the phasing of useful and practicable innovation. I feel that the greatest need at this stage is to get agreement on the design and method of issuance of a CRU. And this can be paralleled, should be paralleled, with the continued enlargement of the Fund as we now know it, without having to create too many additional areas of dispute and nuances of difference in meaning. Thus, I would say it is more important to concentrate on what now gives us a much larger opportunity for fulfilling objectives on which you and I are, I think, largely in agreement. Once these major steps are taken, many of the other questions on needs may fit into place more simply.

HIRSCH

Would I be right in assuming from what you have just said that, on your rejection in your book of the concept of establishing Fund units by transfer of foreign-currency holdings, you see this as, so to speak, not the first priority, rather than ruling it out for all time? Would that be right?

ROOSA

I think that what will happen as far as the currency transfers are concerned is that, if we get a well-functioning unit (CRU) and we find that the Fund itself is also expanding parallel with this, there may be no need for the other. But I would not say that it must be ruled out in principle.

HIRSCH

Can one switch a little now and come on to a number of questions concerning gold? I thought you made some pretty convincing ripostes in your book to what one may call the Despres school in the United States, which is arguing in various forms that the U.S. should play it from strength, so to speak, stand on the merits of the dollar in its own rights, and even threaten to cut the price of gold. I thought that your tactical points contesting this were, at this stage of the game, broadly convincing. What I think is a rather different question, and again I would like to tap you on the historical episode here, is whether in retrospect America rather missed the boat on this one. Specifically: between 1960 and 1962, might not the United States have bought European currencies with gold? I remember making this proposal in 1962, prompted by your own Rome speech where you had held out the possibility that the U.S. would hold European currencies. One wondered then why the U.S. did not make a gesture to show that it was not just talking international monetary cooperation, not just talking the virtues of holding international paper money; why not instead simply buy \$2 billion worth of European currencies for gold? In practice it would have cost you nothing, because obviously you were going to lose \$2 billion worth of gold over the next few years. What really were the operational objections to that? Was it simply the sort of obvious Congressional political difficulties, or was there more to it?

ROOSA

It is hard to remember all the reasons, you know. But I can mention the reasons that now stand out in my mind. I should assure you, to demonstrate how closely we think together, that before the Rome speech the United States had already used a good many millions of gold to buy currencies; we bought Swiss francs, and we had also used dollars to buy German marks after the Berlin crisis of 1961.

These were our first major efforts in this area and when we reviewed them in great confidence with some spokesmen of the Congressional committees we got more criticism than acceptance. But we plumbed a little bit, just to see the reaction to buying what I thought they would regard as the best currencies then available in the world. We had to see where we were. In retrospect, I think we should have worked harder to persuade and explain, or whatever the right word is. In practice, the Administration was quite prepared to buy currencies.

Now there is quite another technical thing. We did not have enough money in the Treasury, in the appropriated funds, to do it. We would have had to do it through the Federal Reserve. And you may remember, and I mean no discredit to the Federal Reserve, that we had to operate our first full year even in swaps (where we were holding foreign currencies) entirely with Treasury money out of the very small pool that we had. I am afraid we did some double counting of the same money in order to get this going. After a year, however, the Federal Reserve felt that the swapping of currencies had been proved well enough to justify them to go in—just to swap. This they could do under their existing statutory authority. There was a Federal Reserve reluctance which always had to be brought along, growing partly out of their natural prudence and partly out of their concern over Congressional misunderstanding.

It is important to understand, in appraising this rather intricate kind of move, that in order to try to bring the American people to realize that we had a deficit problem, a payments problem, we had to resort to the use of readily understandable symbols.

HIRSCH

Such as losing gold?

ROOSA

. . . of which losing gold was the principal one. And if we then were to cast ourselves in a position of saying, "Well it does not matter too much, we are going to sell $2 billion of gold anyway," much of what we were attempting on another front might have been damaged. This was the quite reasonable origin of the prudent aspects of the Congressional resistance. It was a dilemma from which there was no clear and wise answer. If we had had in 1961 the present awareness of balance-of-payments problems in the United States, we probably could have bought currencies for gold more systematically and extensively than we did.

HIRSCH

I must say that what you say now rather confirms one's dubiousness at the time of what Congress would ever say to your piling up European currencies on a completely unguaranteed basis!

ROOSA

Yes, indeed, I do not want to minimize the difficulties in gaining hard public acceptance of any major innovations in monetary arrangements. Of course, buying currencies for gold was the first effort, and even that did not seem very wholesome. Piling up currencies as a result of a payments surplus might not have been any more popular, if it were viewed as an alternative to getting gold from the same country.

All this was a very serious problem. Our feeling on this, as I have said on so many other things, was that we should just try to move ahead with some progress and recognize that we could not gain all these things overnight. We had to realize too with a little bit of modesty that we might not know all the answers and we had better try out first as we went along. And that is why we had to try out first on the currencies. Our total holdings of other currencies, as far as I know—I have not followed the figures too closely since I left the Treasury—have never run much above a half billion dollars, for this same kind of reason.

HIRSCH

On a slight diversion here, I should like to ask you about a constitutional point: your experience with the Congressional committees. While seeing all the difficulties and the disadvantages and, above all, the consumption of officials' very valuable time that this system of Congressional committees involves, I personally am rather impressed by the extent to which this throws up some occasionally pretty sophisticated public discussion. Making all allowances for the rabble-rousing that undoubtedly goes on, it sometimes seems to us that if on balance we had this kind of system here, partly by bringing some of the academics in, but even more by forcing the officials themselves to thrash all the matters out, then it might not be a bad thing. Now how would you, from your own past experience, weigh the positive and the negative side of this Congressional investigation?

ROOSA

If I can start by making it very clear that I have no judgment on what would be right here in London: I agree completely on the value of this process in the American Government. Time-consuming, wearing, exhausting as it is, the net result on balance in every piece of legislation that I had to see through, or any of those which my colleagues handled where I had any close view, was always an improvement.

Moreover, the other side of what you mention is that this process made us much more careful even in the original formulation of what we wanted to propose. For instance, to take a case that is relatively less controversial, now: the interest-equalization tax. We knew, it being so new and different, that we could not possibly, in the closed rooms in which it was being designed before it was first issued as a proposal, we knew that we could not foresee many of the details that would have to go into the legislation. And it was as much our desire to have an arrangement in which there could be extended public review and criticism in front of the committees, as to check the immediate outflow of capital for the purchase of foreign securities, that the Administration followed the unusual constitutional procedure employed in connection with this legislation.

It was for both reasons that President Kennedy carefully requested that the legislation be made effective as of the date following that on which he first announced the proposed tax. Thereafter we had extended criticism from the public and from the Congress, continuing for many months. I was particularly close to the work on this tax and I would certainly say that, whatever is wrong with the interest tax, it would not have been anywhere near as effective as it has been without that extensive review process. Yet, at the time, I must say I certainly resented the strain of it all.

HIRSCH

Sure. Coming back to gold for a moment. Have you ever thought that at a rather earlier stage, when the U.S. gold cover was somewhat better than it is now, and from a position of greater strength, had you ever thought that there might be operational advantages to be gained from a wider spread between the gold buying and selling prices—or even from the contingent thought at the back of people's minds that the United States might one day *lower* the buying price of gold?

ROOSA

I had not thought seriously about lowering the buying price of gold. Perhaps I had not thought hard enough about it. I considered it, of course, from the beginning, in these terms: that we did maintain our parity obligations to the IMF through buying and selling gold within the 1 per cent margin. At an early stage, I did ask whether there was anything in the extra flexibility that might have been provided if we could have somewhat wider margins. But I personally did not think there was enough in it to justify the wear and tear of going to the Fund for a major change of this kind, and so I did not spend very much time with the question. It was part of a canvass of all possibilities, and I put this one down low. At that time, what I did decide was to recommend to Secretary Dillon that we go for the GAB, which may not look to you as an alternative but in my mind then it was.

HIRSCH

Coming now to institutional arrangements. In your book you come out pretty plainly in favor of working through the IMF membership rather than restricting any new asset to the Group of Ten. You also make some compromise suggestions for control through a governors' committee and weighted voting. I am not so much concerned with that aspect. I believe there is now pretty general agreement on some kind of link with the IMF, and equally on some kind of weighted voting; this is the question of ultimate control and of the area of use of the new asset. What I am more concerned with immediately is the more executive function, so to speak, of international credit control. It seems to me that especially in "your" period, and maybe inevitably given the kind of international system that was built up, we moved fairly substantially towards what one can call international credit control through the committees of international officials—central bankers' Basle, OECD's Paris.

Now in a sense I believe that Keynes actually suggested something like that for the IMF: that instead of having permanent executive directors you should have the finance ministers meeting occasionally. So it could be argued that the whole Basle and OECD arrangements are, on a slightly different level, going back to that. Yet from the outside one has clear doubts about this method of control, as against having a bigger executive role inside the IMF professional staff. And I stress executive, because I repeat that we all know that the ultimate control lies, of course, with the world's finance ministers; that is so, whether they work through the IMF or through the committees. But while, in the committee way, you undoubtedly get the world's ablest financial officials, you also get the busiest. You subject these people to the most tremendous strain, of transatlantic flying and the rest, and you ask them to be judges of situations where inevitably they can only devote a very small part of their time to it.

Now I also believe, although I know not everyone will accept this, that there have been some situations, including probably the recent situation of the United Kingdom, where maybe as a result of this procedure, an insufficiently thorough analysis of the position has been made, and the international credit has at bottom been granted too automatically—or maybe too crudely—in requiring as conditions simply the familiar, stock deflationary responses. Now I can see one retort to this, which is to say that large countries are just not willing at this stage to hand over decisions to international agencies. I do not want to get into this argument directly, but rather to assume that, in the years ahead, increased reliance on international credit will involve rather less automaticity at a number of stages. Suppose one takes that for granted, and looks to this medium-term feature. Given the experience that you have had, would you be happy about continuing the recent heavy reliance placed on the international committees, or do you think it would be more effective to have a rather more high-powered IMF staff?

ROOSA

Well, there are three thoughts that I get in reflecting on this. One is that whatever the purposes of the Monetary Fund, it is essential to have a very top-flight staff, from the Managing Director on down. Fortunately, the Fund does have that position now and everything must be done to maintain and encourage it. This is going to be essential regardless of the degree of automaticity in drawings.

But then, second, the Fund now, for the large drawings that provide convertible currencies to a large country, is still dependent upon the General Arrangements to Borrow. There is, from this arrangement, a kind of inherent collision, because the GAB is activated in order to provide additional currencies to the Fund only through the action of the so-called "Special Committee."

It was this need to provide the extra resources that put the committee of experts in its unique role and, thereby, may to some extent have lessened the sense of full responsibility that the Fund staff might have otherwise held. I think the answer to this cannot come in any decree, it has to be found in further enlarging the Fund's own resources so that we do not find that the key situations are always dependent on that GAB relationship.

But the third point to stress is the one you also singled out. We are probably going to have some changes in the degree of automaticity at which Fund resources become available. It seems to me that, over time, we are going to want to increase the degree of automaticity, at least in the first credit tranche, perhaps even more. But this shall in no way impair the role of the executives of the Monetary Fund. It will be up to the Fund staff to make the determinations that underlie the judgment that a country is really entitled to automatic use of the first credit tranche. There will have to be some safeguards and those will be primarily a Fund-staff responsibility—at least to delve into, if not finally to judge.

I think we will see that there is always going to be a little collision between part of what you were after in terms of a strong Fund management and the broadening of liquidity in the form of IMF credits. Although all of us want to have adjustment effectively carried through, many countries also want the feeling that at least a part of their claims on the IMF are as good as reserves, readily available without interference by the IMF staff, however strong and able that staff may be.

I want to stress one other point. I think we have to remember the difference between primary reserves used as a first, certain source available to meet any immediate payments drain and, on the other side, credits which can be drawn from the Fund. That difference has important effects on the working of the adjustment process.

HIRSCH

Even though they could both be within the Fund?

ROOSA

Exactly.

HIRSCH

Feasibly, you could have your primary assets as one kind of Fund deposit, but also have your conditional Fund credit.

ROOSA

Yes. And then we will probably want to be assured through the years that the growth in the primary assets, while always advancing, never advances so rapidly that we remove the likelihood that there will have to be some borrowing from the Fund in large cases, in cases of proportionately large imbalance. This is the way I see an opportunity for reinforcing the adjustment process. First, the simple fact that you have borrowed money that must be repaid is itself a spur to adjustment. Let us take it back a step and say first, the fact that you have used up some reserves you once had gives you some inducement—later on, and when it is convenient—to restore them; but if you borrow, you have a time limit on what you have to repay. There ought, of course, to be a part of the process that is pretty automatic. But then, beyond that, when you get into a really extreme situation, then you need a strong hand in the Fund, where there can be the suggestion of policies that reflect the interests of the world community as a whole, in order to avoid the development in one country of a festering kind of sore that can really be harmful to the whole trading community.

HIRSCH

If we are going to get an acceptable form of international credit-giving, we surely have to give a lot more thought to this question of what one can call executive credit control. And it seems to me that, in a sense, this international-committee system that has developed may work in precisely the opposite way from what we want. It can create maximum embarrassment for the borrower, with minimum real influence on his actions.

I am thinking, in particular, here of the United Kingdom from autumn 1964 until April 1965, when the hoops that were put up by the Paris club became a major political issue in Britain. Maybe that was inevitable at the time of the election, and maybe there is a bit of blame to be laid on the politicians there. But I equally feel—and admittedly on an outsider's very limited knowledge—that there were some unnecessary semi-public hoops that could have been avoided if it had been the quiet and unnoticed visit by the Managing Director of the Fund. As it was, all these hoops and all the public newspaper emphasis on the international credit vetting enormously increased U.K. suspicion of the international credit; and, yet, in spite of all this, what real international influence was there? I remember one of the Continental officials intimately concerned in this credit vetting saying to me, that April, while they were appraising the U.K. budget: "Well, frankly, what is the difference? The estimated deflationary effect is said to be £600 million. Supposing you had done only £200 million, would we really say 'no' to you next week in Paris?" In other words, as this official saw it, the real leverage and the real influence in the credit vetting was very small. Now would you agree that doing the vetting in semi-public, as it is bound to be on a Paris-club basis, is something one ought to try to get away from?

ROOSA

I hope we will get away from that aspect of the vetting process over time, but I doubt that that can be the pattern now. We have a couple of influences on all of this, that are only barely under way. One of them is a growing sense on the part of other nations, now stronger, that they are strong and that they do have resources that may be of great use to the functioning of the whole system—useful at times to finance deficits of the U.K. or the U.S., among others. In this setting, they are not going readily to take an explicit decision that leads to the transfer of executive credit control over claims on their own resources; they are not going readily to transfer that to the separate staff of the IMF. So some kind of vetting, in which these individual countries play a significant part, will surely have to continue.

I think what we can hope for is to channel this into the form of the second kind of new influence, that is, what is being called the process of multilateral surveillance, through which a group of countries meet together to observe each other in good times and bad. They will continue and will include of course recognition, all along, of the way in which countries are financing their deficits or using the proceeds of their surpluses; this process can center on the year-by-year or quarter-by-quarter appraisal of each country by the others. For this, I suspect the best gain will come from operational interrelations among the people who have a key role in the domestic policies of the individual countries.

This is the way in which, without detailed coordinating or implicit direction, there can at least be progress toward harmonizing the domestic and the foreign economic policies of the leading countries. It minimizes frictions.

My hope is that the arrangements for multilateral surveillance, for mutual self-criticism, will lead to the adjustment process working more smoothly and, in a sense, working without regard to the way in which the Monetary Fund itself has to be called upon. Then the role for the Monetary Fund as the executor of the credit decision will be stronger and, at the crucial moments, more effective. I agree that we need a strong role for the IMF as a dispassionate international judge. As an effort to appraise what is likely now, I say the best way to strengthen that is not to try to put too much of the whole adjustment process on the Fund itself, but to do more through multilateral surveillance before the stage is reached where a country must have massive credits. We should try more for the preventive rather than the punitive.

HIRSCH

Clearly, this adjustment process is crucial here: it is implicit in my doubts about the real leverage that the creditor countries nowadays have. In a sense, I think one could argue that certainly for the United Kingdom and the United States the whole question of any international credit control is to some extent an illusion, while one has total rigidity of exchange rates. What my Continental official really had in mind when he said "Even if you had not done any deflation, we would still have given you the money," was surely that if the United Kingdom says—or implies—"If we do not get the credit, we can only let the exchange rate go," then naturally the other club members have to cough up. Now, the questions I am really putting are: do you believe that if one maintains total rigidity of exchange rates one can be sure of getting the right leverage behind the international credit control? And, secondly, and beyond that, do you think that one can afford, for the commendable goal of stability, to give up this powerful weapon of international adjustment for the large countries—which may be the ones that need the exchange weapon most (because it takes a larger change in their domestic spending to secure a given change in their foreign balance)?

ROOSA

I do not think we ever will completely give up the possibility of exchange-rate change, although the position of a reserve currency is quite special in this regard. The IMF certainly provides for rate changes. But there is no question in my mind that the present world economic environment requires exchange-rate stability as a discipline. That is, if governments of the leading countries were free to compete with each other, in influencing their own or another's exchange rate, then I think the present orderliness of payments relations would rapidly break down into a world of fifteen or twenty Hjalmar Schachts fighting one another. Trade would be fragmented—and none of us would wish that. But I know that such conditions of competitive depreciation are not really what you are talking about.

HIRSCH

No, no.

ROOSA

I am just taking this as a starting point. So that we have to pull back from this full freedom for fluctuating rates to see what is the most reasonable scope for possible rate changes. Since World War II we have had the big devaluations of 1949, followed by other individual changes, running on through the French further devaluation of 1958, and then the appreciation of the mark and the guilder in 1961, and the depreciation of the Canadian dollar in 1962. This is enough to illustrate that over the postwar period rates have not been immovable. There have been changes, but they have been discrete changes made from time to time on the basis of a cumulative need. What has made the pound and the dollar special is that, as reserve currencies, they carry in this respect too, if you will forgive me, an extra burden.

HIRSCH

Oh, I agree there!

ROOSA

And it may be argued that this is too much of a burden, that the price is not worth paying, because it imposes on them a clear obligation to effect adjustment through internal correction instead of at the frontier through the exchange rate. My own view is that the United Kingdom and the United States do have a right to expect the other countries (now that their strength entitles them to a position of greater positive responsibility in the whole currency system) to maintain stable rates and the discipline which this will imply for them domestically and internationally. This is the environment in which maximum trade gains can be achieved. But the leading countries, then, also have to be prepared for financing deficits through periods of corrective adjustment of a different duration and magnitude from those experienced in earlier days.

HIRSCH

If they want the stable rates, they must be prepared to hold the dollars.

ROOSA

Exactly.

HIRSCH

. . . and the pounds.

ROOSA

Exactly, or, at any rate, to provide sufficient credit.

And so, having moved back from the extreme of complete Schachtian chaos on the one side, I would also fall back from the other extreme where there is a presumption that there will be no rate changes at all. That would probably be a difficult world to live with forever, just as the world of the 1930's could not continue. As to the particular positions of sterling and the dollar in this environment, it seems to me that the first scope for rate flexibility should not be, and has not been, a change in the so-called "spot rate" outside the existing spot margins, but instead a greater use of the variations, possibly well outside those margins, in the forward market.

Now I am not saying that this corrects a structural disequilibrium. But in those periods when longer-run correction has to be worked out, and when there will in the process be periods of fairly intense pressure on a given currency, then I think there is a role for a kind of guarded fluctuation in forward rates. It has an elastic limit, but one that can take a fair amount of pressure, absorb a number of the things that we would be worried about, all without having to give up the benchmark of the stable spot rate.

I would not want to rule out for all time a negotiated adjustment among some individual countries, or at least an informally agreed adjustment—it may not be possible to negotiate on this. Without wanting to rule that out for all time, I do believe that the world has a sufficient stake now in this kind of stability that I should like to see further development of the range of variation in the forward market without going outside the present limits for spot fluctuation, before making any further decision on what may be necessary on the spot rates.

HIRSCH

On the forward rate, I confess I am not entirely with you there, and I was also puzzled by similar points in your book. I can see that operations on the forward rate can have some of the same effects as fluctuation in the spot rate in so far as it affects movement of short-term money. It influences interest arbitrage, and *can* make exchange speculation less of a one-way option for the speculator. So I can see that this can help you in countering movements of hot money. But I do not quite see that it has the same power as a relative depreciation or appreciation of the spot rate to influence current trade and payments. That is my first difficulty. My second difficulty is that, as I understand it, the recent official interventions have narrowed rather than widened the spread between these forward rates. The intervention and official manipulation of forward rates, which again I believe you were very largely responsible for introducing in 1961, and which to some extent other countries, including Britain, have followed, and which I am sure has been a very good thing, has been aimed mainly at the arbitrage margins. This has, if anything, worked to narrow the earlier range of fluctuations in forward rates, which have in sterling's case always been free, or at least since 1951. There is no IMF obligation to peg these forward rates. In our recent crisis, the authorities intervened on a pretty massive scale in the forward market, to keep the forward discount smaller than it would have been, in order to take pressure off the spot rate and the reserves. But this is an official intervention that is in effect *reducing* the scope for fluctuation in the forward rate. That is my second difficulty.

ROOSA

There are more than two difficulties there, I am afraid. The first one: your point that it affects hot money but not money involved in trading is, I think, half right. It does not, as I meant to imply, take care of the sustained deficit position resulting from a structural imbalance that persists year after year. But it does, I think, affect more than the hot money—which, of course, it reaches. It affects the extent to which a country will be subjected to the strain of shifting leads and lags. It does that by providing a facility through which traders, instead of causing large reserve losses by unloading in the spot market, for example, resolve their doubts or uncertainty by paying a small price in the forward market.

It has been my guess, without ever knowing, that, for example in the U.K. situation, the swing magnitude either side of a theoretical zero point would be at least a half billion dollars equivalent. That is, a half billion accrual if the U.K. is gaining from the leads or a half billion loss if the U.K. is losing from the lags; and I think that is probably so conservative a figure as to be close to ridiculous.

HIRSCH

Yes, but that is still short-term capital, is it not—those leads and lags in commercial credit?

ROOSA

Well, it is the payments patterns for your trade movements. What it really concerns is whether or not people are going to go on in the routine of paying for the goods that move in and out, not only in their payments with the United Kingdom but in trading all round the world. And that leads me to a part of your second point, which was that forward operations had seemed to have the effect of narrowing the spreads. Of course, at times the operations reduce the spread between the spot rate and the forward rate—but the zone over which the forwards swing is certainly much wider than the plus-minus 1 per cent limit for spot rates. But what is more important is the effect exerted just by the knowledge that there is central-bank activity in these markets. Reinforced with the swap network, which will always assure that contracts can be met—if necessary by drawing on a swap with another country when they mature and have to be paid instead of rolled over—central banks can give convincing assurance to traders and bankers everywhere. This combination is assuring a much broader forward market than we ever had before. In part, some of the apparent narrowness of the market spreads is resulting from the fact that it is becoming a better market.

Until ten years ago, for example, you could scarcely buy or sell a Canadian dollar forward in the United States, though Canada had at that time a fluctuating rate. There just was no one who would make, on a day-to-day basis, a market in forward Canadian dollars—the closest currency to the United States. Now you have active forward markets in at least a half dozen of the leading currencies vis-à-vis the dollar and, of course, in these currencies vis-à-vis one another. I think this is a crucial part of the development, that we can rely on.

Just to wind that up, I think the activity that has occurred in just the last five years has now provided the basis for broader and more active forward markets, which gives us for the first time an opportunity over some years ahead to find out whether this can do more for us. And what appeals to me is not that it solves everything, but that it may absorb those crucial marginal changes that add the unbearable excess of pressure over and above the kind that could be handled through normal credit relations of a short or medium-term variety. If this should be so, I think it is well worth the experiment, to learn about these potentials while we do have at least the principal countries now settling down to an environment of stability in their spot rates.

This does not mean that I want to rule out the conceptual possibilities of somewhat wider margins. A number of people who know a lot more about this than I (including at times, Herr Blessing, Dr. Kamitz in Austria and others, and perhaps even more recently, Dr. Holtrop) have referred to this as something that needs looking at. I have only this to say about it: I do not think it should ever stand in the way of the fundamental kind of changes in payments arrangements towards which we are now working and on which the international group is negotiating. I think that there are some people who have used the idea of wider margins for spot rates as an alternative, and I do not think it can be. There is here a modest potential for improvement—and for now I should like to see what we can do with this variation of forward rates around the existing spot-rate margins. And remember that, over the past three or four years of these experiments, we have had times when those forward margins have been extended as far as 4 per cent from par—a little over 4 in the case of Italy at one time; and, in Germany, going up the other way, it has been somewhat over 4; and, of course, in the British case, I think it got to something like 3 per cent below.

HIRSCH

But it was then limited by intervention.

ROOSA

Yes. So that we have had, in this area at any rate, a fluctuation that falls somewhere within the band that many of the more responsible critics have suggested—the so-called "5 per cent band" of plus or minus. And it is here that we are getting the fluctuation in the forward rates without having to give up the certainty provided by the spot rates. I think we may discover that we have a mechanism for getting the best of both worlds. I suppose that has never happened yet, so I should not hope for it now, but I would like to try.

HIRSCH

Just working this one through: this is saying that supposing sterling is at a discount of 4 per cent against the dollar, then a U.K. exporter, by selling his dollars forward, would have an additional inducement to earn dollars, because, after all, he gets the premium. I see that. Yet in practice, in the sterling context, recent actions have rather worked the other way. The authorities have decided, and in my view it is difficult to see how they could have taken another decision, that they could just never let the forward discount go to 4 per cent, as it did in 1957 and

1961, because that would produce so much hedging on the spot rate that the reserves could not cover it.

ROOSA

Yes. That is what I meant in saying that there is an elastic limit, and that is why we have to see how it works out, because in the British case the forward rate got far enough down, thinking in terms of dollar quotations, that it was within a hair of pulling the spot rate below the 2.78 margin—and, of course, it could not be allowed to do that under the IMF commitments. Therefore, if the forward rate had been allowed to go any further, it would have required massive intervention in the spot market. Thus, rather than allow that pull to go on, the authorities did much more in the forward market and therefore conserved their spot exchange. This was on balance, first of all, a saving to the United Kingdom of hundreds of millions of dollars out of the current reserve. And, second, it did provide a period of bridging in which those who were alert and able to take advantage of it had, on the export side, an advantage which they should have seen was greater than the export subsidy that was being provided.

HIRSCH

Yes. Except that most exporters were doing the opposite. . . .

ROOSA

That is right.

HIRSCH

. . . I mean they were not taking their possible forward premium, they were playing the leads and lags.

ROOSA

They were so afraid they were still in the lead-lag situation. But that is because this is new.

HIRSCH

I suppose it could be that. I can see that the forward rate can make some contribution. The question of whether one wants an additional contribution obviously depends on how urgent speedier adjustment is. I totally agree with your formulation where you say that the people who want stable rates must be prepared to finance larger swings. I am not quite so agreed that when the reserve-currency countries renounce the use of exchange rates, they have in practice committed themselves to making the adjustment through their domestic economies. Clearly, this could be so; this is why many of us fear that this might involve either inadequate growth or, even worse, unnecessary unemployment. I think that probably we have got far enough now that, while we probably do tolerate a little sacrifice in growth, we very rightly would not tolerate too much additional unemployment, and in the end the exchange rate would go. Things have not got to that pass yet, which in a sense has made some people think: "Well, in that case where is the constriction?" But, looking at the last couple of years, both in the United Kingdom and in the United States, surely we have taken the adjustment not so much on our domestic economies, but on our capital accounts. Because under present exchange rates the accounts have not balanced, we have imposed a direct check on the outflow of capital—both through fiscal means and with exchange control, in both countries. At the moment, this is in a sense the biggest danger point in the world economy, in that we are tending to freeze up the supply of private capital, or certainly to dampen it. And the particular difficulty seems to me to be this.

In theory, and as you started urging in Rome in 1962, the surplus countries ought to be stepping in. After all, they can afford to supply the capital on a purely national-income/balance-of-payments basis. The United Kingdom and the United States, on their balance-of-payments reckoning, cannot. Therefore, the natural thing ought to be that the Continentals supply the capital. And, indeed, some of them, the Germans in particular, accept this and would like to supply more capital; they have been trying to do so for a number of years. But, whereas they could theoretically supply all the foreign lending they wanted in public loans or aid, their success in getting private-capital markets going has been much more limited. The great blockage has been this institutional factor of getting a capital market going, of getting investors to entrust their savings into long-term monetary form, and above all into long-term foreign investment.

To overcome the institutional barriers does seem to be a very difficult and a long-range thing. One is probably up against quite long-range historical habits and experience: the loss of French investments in Russia after the Russian revolution, the expropriations in Germany after both world wars, and that kind of thing—not to speak of the inflations, which, again as you pointed out in your book, have really made Continental investors themselves distrust their own currencies. The talk at the Paris club may be about the weak dollar; but the European saver knows different on a longer perspective.

The point I am building up to is this. Given the primacy, or the apparent primacy, of this institutional factor in private-capital movements, one does get into a very awkward situation when those countries that *have* both companies and individual savers who are anxious and willing to invest overseas *do not have* the requisite foreign-currency surplus. When those countries, that is the United States and the United Kingdom, are, so to speak, stopped by their national balance-of-payments accounts from following their natural capital-exporting inclination, you do not get an offset coming in, as it theoretically should, to make up the loss to the international capital market. What one wonders, therefore, is this: should we not be terribly hesitant about checking this kind of foreign lending from the very few countries with institutions and past experience to make them willing to undertake such lending?

Many central bankers will agree there. But the essential corollary is: should we not be more willing to take the adjustments on the other side of the account? This means—except under conditions of intense inflation, where domestic deflationary measures are fully sufficient remedies—to accept the strain on the exchange rate. I think one should remember here that exchange rates would themselves influence not only the current account but also the capital account itself. If it gets more expensive for a British company to buy French francs, and more expensive for an American company to buy German marks, that affects the investment decisions as well as the trading decisions. Thus, by invoking the exchange rates, one can get a certain market influence on the capital account, as well as stimulating the larger surpluses that one needs on the current account. I should like in a moment to come to the technical forms which one might use for this kind of exchange-rate adjustment without some of the compensating disadvantages. But I should just like to ask you, first, whether in any sense you would agree with this kind of presentation.

ROOSA

It has been so much, it is hard to say whether I agree overall or disagree. I guess I shall just have to qualify. On the domestic impact for a reserve-currency country—when it must do its adjusting through internal correction and cannot alter its own exchange rate—I hope we have learned that this does not have to mean self-inflicted deflation or contraction. The pattern can, and should I think, be that of accomplishing change within the economy while output and employment grow, or at the worst mark time for a part of the adjustment period. This does, of course, mean the heavy use of outside finances and of one's own reserves.

On your point of apprehension concerning any action that would limit outflows of capital, because these outflows are an essential part of the whole structure of developing world growth, I fully agree. In the United States policy, we were hesitant; we took action on this front last; we tried, indeed, to follow your requirement that it should take a market form. That was the nature of the interest-equalization tax, that it just added an interest charge; and even now in the voluntary program, the aim is simply to provide an overall indication of the possible increase, and to keep the scale of the increase somewhere within the bounds of our current-account surplus, rather than to cut it back. In that respect, I think that we are doing about right and, interpreting our performance in that way, we think that it does square with what you have outlined.

None the less, it is true that we could be exporting more capital, and it gets down basically to the question: how can that be done, given that we have the firms that are willing and the savers who are willing? We do not have the external payments position that allows more; but the favorable payments position, that missing link, exists in other countries that do not have either the savers or the investing firms. Now in the past, of course, that link has been bridged by the holding of dollars and foreign-exchange reserves in those countries, the counterpart being a substantial outflow of investment from the United States. We have passed the limit of that as far as present tolerances go, so that now we do have to find other ways. And one of those other ways is again coming about in a market sense—perhaps inadequately—through the very heavy additional borrowing that American firms are now doing in Europe, most of it in the European dollar market. The gain that this is providing—apart from many of its other perhaps more questionable side-effects—is that in the countries where surpluses exist, to the extent that borrowing is now permitted, the American firm with its own readiness to spend funds abroad—and outside Europe for that matter—is serving as the conduit, and I hope in time the catalyst, for a great deal more of the energizing of both European firms as competitors and, in time, European capital markets as institutions. But I grant you this takes a long time.

HIRSCH

But are these really *European* capital markets, or are they again simply extensions of the New York capital market? After all, the bonds are denominated in dollars, the subscribers are partly international investors who would otherwise have bought United States bonds, and partly United States citizens themselves. Admittedly, there are also some Continental investors, but even among them, to a substantial extent, these dollar bonds are simply an alternative to United States bonds. Is this really the kind of market you had in mind in 1962 when you said to Europe: "Now make a capital market"?

ROOSA

No, no. This is not enough, by any means. But the requirements of this capital market are going to be three things, broadly—all of which, by the way, exist in the United Kingdom: (1) highly developed, diversified financial intermediaries, through the range from deposit banks to instalment-loan companies; (2) substantial flows of savings being channeled through the skilled intermediaries to find profitable uses; and (3) business firms prepared to borrow the funds in ways that will lead to their being employed abroad.

Now, the difficulty in the European market is that they have not yet developed those three conditions. Our hope in 1962, at the time of the Rome speech, was that there would be more ready recognition of this sort of need. We hoped that Europe would move into a position where it would become an active creditor continent, a series of creditor nations, providing this extra substance for the capital development of the world that has always been needed from somewhere, through the whole history of industrial economies in the world. And yet there was not very much acceptance of that; and what there was has been slow and oral rather than positive in remedial action. So that I think that now, having gone on for another couple of years with very little happening, the next step is to be a good catalyst at a time when we have gone beyond the capacity of the American economy to do more in the way of increased foreign lending; all we can do is maintain the average of the years 1962-64. We are not cutting back behind that, but we are holding to that average.

At this stage, when we have all the three capital-market facilities and Europe does not, we can do something ourselves in Europe, by example and stimulus, through this new dollar-loan market. But there is much more to it than the mere fact that it is an extension of the American market. No doubt it is, in substantial part—I would hate to give the fraction, but probably at least a quarter of the dollars specifically invested in any given issue by an American firm in Europe have been pulled by some European out of a holding already in the United States. In that sense it is no gain at all to our balance of payments. But I would say that does not matter, as long as we do not get down to the point where practically all of it comes this way, because we are still reaching some European investors who are having to be confronted with new kinds of opportunities in a European environment. They are being met by alert underwriters, and getting acquainted with such things as convertible debentures—the types of things which they did not even know about in story books before this intrusion occurred. I think there is here the kind of potential for learning by example and exposure that may serve as a catalyst to bring about somewhat more rapidly the lending of European savings all round the world in a way that will help to close the present gap or break the impasse.

HIRSCH

Are we quite sure that European reluctance to invest abroad might not be in part related to a relative undervaluation of the exchange rates? And to put it the other way, is not British and American eagerness to invest aboard partly related to their relative overvaluation? All I am really saying is, does not the exchange rate have an effect on capital movements too? So that, at the moment, a German has to give up too many marks to build a given factory in America, or in Peru?

ROOSA

Well, I think if you want to take the American case, that I would disagree. I doubt very much if there is anything out of line sufficiently to be a determinant in decisions of that kind, at any rate between the dollar and the mark at the present exchange rate, or the franc, or even the Italian lira. It was because we thought the Italian lira was in line, when its neighbors in Europe did not have the same confidence, that we took the lead at the time when effort was needed in order to validate the present rate. At this moment, and given no further massive changes in domestic-price levels, I think this is one reason why there is more being invested in these dollar issues in Europe than comes solely from the United States or existing investments.

HIRSCH

They trust dollars—European investors trust dollars more than their own currencies.

ROOSA

I think they do, and I think that is why the money is flowing out in this way and that to some extent they are, from a domestic point of view, spending marks to buy dollars to buy convertible debentures in General Electric, and this is one way—to the extent that it works—that we may be able in part to break the present log jam.

HIRSCH

Taking you up now on your conceptual acceptance of a possibly wider range of fluctuation in exchange rates, could we explore the two main forms in which this might be done. Traditionally, and what most people still have in mind there, is simply the wider spread around the fixed parity: instead of the present maximum one per cent on either side, say 3 per cent—such was considered in 1955—or maybe even 5 per cent either side. Now it seems to me that there are two quite substantial possible disadvantages there. First, one undoubtedly does get considerable uncertainty for traders with a range of movement of up to 10 per cent, which would mean 20 per cent between two currencies at opposite extremes. And, although this can be covered by forward facilities, they may be very expensive. Thus, there will probably be some disadvantages for trade, some disruptions in the process of international integration and eventual monetary union. Secondly, especially for sterling or the dollar, it seems to me that, given the weight of the purely financial transactions in the payments balance of the short-term investment in relation to trade, you never really have any certainty that the rate is going to land up in the right place. In other words, it is perfectly possible in a situation of basic deficit, say the United Kingdom in the first nine months of 1964, that you might be near the top of the range, simply because of the cushioning of foreign funds. In a way, one saw this disadvantage with Canada's floating rate in the 1950's. This may have been because of a misguided interest-rate policy; the fact remains that they had a theoretically floating rate which was never really in the right place in relation to the trade balance.

Now it seems to me that one might get over all these things and yet still have a scope for exchange-rate adjustment by what James Meade calls the sliding parity. This is to have fixed parity rates, still with only very narrow scope for market fluctuation either side—but with a possibility of adjusting those parity rates themselves at frequent intervals, say every six months, or even monthly. They would be adjusted by small, openly declared amounts, say 1 per cent every six months, or 2 per cent per year. This would have two advantages. First, the maximum percentage would be known and easily discounted; so the hot-money effect could be easily offset by interest-rate differentials, and relatively small ones. If you know that the rate can move by 2 per cent within a year, you cover that by a 2 or 4 per cent interest differential; and secondly, and in a sense this seems to me the most attractive thing of all, this can be a much more conscious process of decision. In other words, whatever the hot money is doing, the government can decide at its six-monthly point of decision that the 1 per cent adjustment is appropriate; so that within say five years you can get a 10 per cent devaluation, or upvaluation, which is quite a considerable cumulative adjustment. And, in what may be the most refined form of this proposal, Meade suggests that any country that is borrowing from the IMF might actually be required to make this adjustment. One would then have this automatic process which would dispense with awkward political choices about very tiny movements—and could also diminish with the danger of competitive depreciation. What would be your views on choosing between the wider margins and a sliding parity?

ROOSA

I have such great respect for you and Meade that I hesitate to imply any judgment as extreme as this comment will imply. I am unable to see how any arrangement which indicates a potential scale of incremental changes cannot be handled by a moderately sophisticated actuary on terms that would give you the present discounted value of the possible changes and lead to expedients that would reflect in the market place a value somewhere around that present discounted value. Alternatively this may merely mean that the market, unable to accomplish this immediate change, will freeze so far as the specific currency is concerned. I therefore have been intellectually unable to understand how this device can be expected to work. I am sure this reflects some lack of understanding on my part, but I can only say that having heard one of the earlier expositions given by Professor Meade on this subject I expressed the same reservation at that time and have not yet read or heard any explanation that satisfied me that this criticism was invalid.

HIRSCH

Surely the key point about the discounting of the future value is that this is to be offset by the interest rate; and that if you can only move 2 per cent on the exchanges then a 2 per cent interest differential (or 4 per cent against a potentially appreciating currency) looks after that.

ROOSA

I do not see how, if the indicated range of exchange-rate change is much greater than that over a longer period.

HIRSCH

As a last point, what are your views on the "aid link," which some people would see as one of the most important issues in the current debate. Central-banking opinion, sometimes even some parts of the IMF too, contend that aid is one thing—the transfer of real resources—and liquidity is quite another thing—an oiling of the monetary mechanism. Now there is an increasing school I think that would dispute this view, and accepts that any dispositions of reserves can involve transfers of real resources; and would like the creation of any new monetary claims to go at least in the first instance to the developing countries. Do you agree with this, and what would be your preferred technical form?

ROOSA

I have changed my mind several times on this one. I once thought that there could be a link directly and officially between the machinery for creating additional liquidity and the extending of some form of aid. I now believe that the difficulties of achieving appropriate arrangements for creating a new unit are so great that they cannot carry the additional burden of also being responsible for a rather crucial set of aid decisions at the same time. I would not want to burden the liquidity arrangements with an aid responsibility directly. I do think that there must be provision within the liquidity-creating arrangements for a "set-aside" of some part of the new liquidity. Some fraction of any new CRU's, for example, could be paid over to the IMF by the contributing countries and then be used through the Monetary Fund to provide supplemental drawing facilities on easy terms for the other Fund members—that is those who do not contribute to the creation of the new unit.

I think that for the next few years it will be necessary, but also adequate, to provide in this way some additional resources for the use of other countries, including mainly the less developed countries. The actual aid requirements are so vast and so complex to meet the special needs of the many needy nations, however, that I would myself prefer to see tailored arrangements for this maintained separately from liquidity creation for some time. This does not mean that any individual country receiving CRU's through its participation in the creation of the new unit should not be encouraged to make an individual national decision to contribute any part of its reserve holdings to the international bank or any other international institution for use in providing additional development assistance or aid. But that is a separate decision for the individual participating country to make, once the whole process of liquidity creation has been completed. This seems to me the best way to leave matters, for the next few years at any rate.

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