

ESSAYS IN INTERNATIONAL FINANCE

No. 63, November 1967

CHANGING THE UNITED STATES
COMMITMENT TO GOLD

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INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS

PRINCETON UNIVERSITY

Princeton, New Jersey

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International Finance Section

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CHANGING THE UNITED STATES COMMITMENT TO GOLD

On March 17, 1967, the Secretary of the U.S. Treasury made a speech before the Annual Monetary Conference of the American Bankers Association at Pebble Beach, California, that greatly stimulated public discussion of the possibility of unilateral action by the United States in case other countries did not cooperate in "enabling the United States to deal with its [balance-of-payments] problem," thereby undermining the international monetary system by subjecting it to "radical and undesirable change."

Before Secretary Fowler's remarks at Pebble Beach, most public discussion concerning the role of gold and the dollar in the international monetary system was confined to academic circles. Shortly after Mr. Fowler's speech, however, two major banks, Chase Manhattan and the Bank of America, challenged the desirability of the Treasury's inflexible gold buying and selling policy, thereby adding a new dimension to the controversy. They made the suggestion that the United States should, in future, deal in gold with foreign central banks only at its own option. Former Under Secretary of the Treasury Robert V. Roosa, Executive Vice President of the American Bankers Association, Charles E. Walker, and officials of the First National City Bank of New York rushed to defend the *status quo* on gold and the dollar. Chase Manhattan subsequently "clarified" its initial remarks by issuing a statement generally interpreted as a retraction. Later, the American Bankers Association too released a comprehensive policy statement strongly in support of maintaining the close link between gold and the dollar.

The line of argument for breaking the close link between the dollar and gold is generally based on the observation that the existing supply of monetary gold is limited; that private world demand for gold is increasing and now exceeds the current supply of newly-mined gold (at the fixed price of \$35.00 plus a small service charge); and that, to ensure continued stability of the present international monetary system, countries would have to demonstrate far more willingness to assume responsibility for the system's viability than they have in the past. This would involve such steps as pooling existing monetary gold stocks to ensure confidence in continued dollar-gold convertibility, adopting more appropriate fiscal and monetary policies, and liberalizing restrictions on capital exports by surplus countries. Continuation of the present trend can only result in further drains on the limited stock of U.S. Treasury gold,

reductions in overall international liquidity, inefficient and increasingly restrictive balance-of-payments controls—reduced levels of international trade, investment, and foreign aid—and higher levels of interest rates, all of which tend to retard rates of world economic growth.

On the other hand, those opposed to breaking the close tie of the dollar to gold stress the importance of a moral commitment of the United States. The policy statement of the American Bankers Association makes the case as follows: "One of the regrettable features of recent public discussions of the gold problem is the extent to which they have ignored the obligations of the United States to fulfill its commitments to nations which, having accepted official reassurances that our gold policy will not be changed, have helped finance a long string of U.S. deficits by adding to their dollar holdings. A number of nations have thus put their national interest on the line in failing to press for conversions of dollars into gold, although it is noteworthy that a few others have not."

Some observers also regard the existing close link between the dollar and gold as a fundamental requirement for a stable system of fixed exchange rates. The ABA statement, for example, considers the maintenance of gold-dollar convertibility at the fixed price of \$35.00 as "the foundation for a system of stable rates of exchange"; any change in this role of gold, it maintains, would be a serious threat to the international monetary system "which has served the world so well since it was outlined at Bretton Woods in 1944." (These sentiments are in marked contrast to the ABA's former position of firm opposition to Congressional enactment of the Bretton Woods Act. In February 1945, the ABA warned that the proposed International Monetary Fund was "unsound," would increase the "grave danger of inflation," "delay fundamental economic adjustments," and "fail to protect the principles and interest of the United States and its citizens.")

It is obvious that one possible way to sever the close link between the dollar and gold would be for the United States unilaterally to allow the dollar to float with respect to both gold and foreign currencies. Although such action should not be ruled out as an entirely unacceptable alternative, it would, of course, represent a radical departure from the present international monetary arrangements and, therefore, should be regarded as a last step, to be resorted to only after close examination of less radical alternatives. One such possibility, should continued gold losses persist to the danger point, for example, would be to preserve the present link between the dollar and gold—in terms of maintaining the official dollar price for gold and United States obligations under the IMF Articles of Agreement—while at the same time eliminating the present commitment of the United States to buy and sell gold freely on the demand of foreign

monetary authorities. This could be done by instituting the so-called "current-account convertibility" status for the dollar—the present status of *all* other "convertible currencies" under the IMF Articles. As will be noted in the concluding section of this essay, one effect of such a change in the convertibility status of the dollar would be to set the stage for the possibility of a further change in the link between gold and the dollar without requiring a radical and unilateral action by the United States.

The term "current-account convertibility" can be defined as a legal status in which convertibility of a currency may be either to gold or to the currency of the country demanding the conversion, at the option of the country making the conversion, and in which conversion may be legally required only in the case of currencies acquired in current-account transactions. However, it should be noted that, although the IMF Articles of Agreement may require only *current-account* convertibility, the actual degree of convertibility of most currencies defined as convertible under that status goes beyond the narrower requirement. Indeed, for this reason the term "current-account convertibility," although a neat and legally valid expression, is somewhat misleading. The principal technical distinction between the convertibility status of the dollar, as compared with that of other convertible currencies, derives from the fact that dollar convertibility is achieved primarily by freely buying and selling gold against dollars on demand of foreign central banks at the fixed price of \$35.00 (neglecting service charges), while that of other currencies derives from central-bank intervention in the foreign-exchange markets whenever necessary to maintain their fixed exchange rates (within the narrow range of allowable fluctuation).

As will be discussed below, the adoption of current-account convertibility for the dollar would eliminate restraints imposed on the U.S. Treasury by the physical limitation of the size of its monetary gold stock. At the same time, national and international commitments of the United States, legal and moral, would be left inviolate. Accordingly, to the extent that its international payments difficulties can be equated with a physical shortage of gold, such action should help to "solve" the payments problems of the United States.

This essay will consider the case for adopting current-account convertibility of the dollar. The technical effects of such action on this country's payments situation and the international monetary system will be examined, and the results then considered in terms of the impact on the structure of international monetary power and implications for the future. A selection of various provisions of the IMF Articles of Agreement of particular relevance to this essay is presented in an Appendix.

It should be stressed that the purpose of this essay is to analyze, not

advocate, solutions. This stand is taken because all so-called "solutions" imply political and economic consequences which, in turn, imply costs to some and gains to others. One's judgment as to what should be done, therefore, really depends on one's own goals and prejudices. The goals and prejudices of the author, though dear to him, contribute nothing to the choice to be made.

Obligation of the United States as a Member of IMF

It may be stated at the outset that, as various authors (for example, John Parke Young in a recent essay in this same series) have asserted, there would be no contravention of the IMF Articles of Agreement if the United States decided henceforth to sell or purchase gold only at its own discretion. However, the assertion, as stated, although literally correct, is incomplete and misleading.

The United States, like other members of the International Monetary Fund, is obligated under the Fund Articles to maintain within its territories exchange rates between its currency and the currencies of other members within the limits of plus or minus one per cent of the defined parities of the currencies. (Article IV, Section 3-i.) However, under the second sentence of Article IV, Section 4(b), any member is deemed to satisfy this obligation by in fact freely buying and selling gold (within margins prescribed by the Fund). The United States, unlike any other member of the Fund, has so far satisfied its obligation to the Fund under IV(3)(i), by freely buying and selling gold in accordance with the second sentence of IV(4)(b). This means that if the United States decided no longer freely to buy and sell gold, it would have to satisfy its Fund obligation under IV(3)(i) as other members do, by maintaining exchange transactions in its territories with respect to other members' currencies within plus or minus one per cent of their parities. Thus, even a complete cessation of gold sales and purchases with other monetary authorities would not in itself be a violation of the Articles. However, a violation *would* occur unless the United States then began to buy and sell currencies in its territories as and when necessary to support their parities within the one per cent margins.

Technical Problems of Operating in Foreign Currencies

A switch to supporting exchange rates of currencies within its territories by the United States, instead of maintaining free dollar-gold convertibility, would involve certain technical problems. These problems, while not insurmountable, nevertheless present greater complexities and more of a burden to the United States than is the case for other countries. First, since there is no other national currency with the international

status of the dollar, and since the dollar is actively traded in the exchange markets of all other countries, the United States would have to engage in exchange operations in a proliferation of different currencies. Working balances (reserves) in a correspondingly large number of different currencies would have to be maintained by the Federal Reserve. This is a very different situation from that faced by nonreserve-currency countries, which operate virtually only in dollars (or some other major international reserve currency) to fulfill their Fund obligations. Such countries simply have little or no call for exchange transactions in other currencies. Second, the need for the United States to maintain balances of nonreserve currencies would expose it to risks associated with the holding of currencies less universally acceptable than the dollar and with histories of greater weakness and instability. Other countries generally do not want to hold such currencies. They prefer the dollar, which is backed by the economic strength of the United States and has worldwide acceptability, a long history of a high degree of monetary stability as compared with other currencies, and a world-wide banking apparatus. Third, the fact that the United States would support a foreign currency within its territories at a particular exchange rate, while the counterpart country would support the dollar within its territories at a particular exchange rate for its currency, means that the two rates would have to be closely coordinated. Otherwise, large international currency flows between the two central banks for purposes of arbitrage could be set off. Although such coordination is achievable, it should be noted that the exchange rate of a currency reflects not only official policies, but also changing market forces capable, at times, of shifting with great rapidity. To maintain consistent reciprocal arrangements with respect to the point at which each country would have to intervene in the market could require a multitude of bilateral consultations, all subject to rapid modification to avert undesired reserve or exchange-rate movements.

It may be noted in this connection that maintenance of the exchange-rate obligation under Article IV(3)(i) is territorial. When a given rate relationship between two currencies threatens to move beyond the limit of one per cent from par, there is, from a conceptual viewpoint, a fusion of two territories in which the obligation to maintain exchange stability is applicable. There is, in effect, a single territory (usually noncontiguous) in which two monetary authorities are operating. The necessity for full coordination, and, in the process, for sharing a sovereign function, is obvious and inescapable.

To some extent the existing network of "swaps" between the Federal Reserve and the central banks of some eleven countries represents an example of the type of arrangement that would be particularly useful

under current-account convertibility. However, the swap arrangements presently in force were created under the existing circumstances, in which the United States is not legally committed to maintaining the parities of foreign currencies with respect to the dollar within its territories. Their existence is therefore much less critical than would be the case under current-account convertibility. Moreover, drawings under the swaps require reversal in 90 or 180 days, or sometimes can be extended to 270 days, while the swap facilities themselves can be terminated. As such, they may unilaterally be eliminated or substantially reduced on renewal. This risk would become more urgent under current-account convertibility of the dollar, thus indicating a need for the United States to hold a "permanent" stock of foreign currencies.

It should also be noted, however, that member countries are obligated under the Fund Articles to promote exchange stability and to maintain orderly exchange arrangements (Article I-iii). Article IV(4)(a) also obligates each member to collaborate with the Fund to achieve this end, thus increasing the possibility of avoiding deliberate policies of non-cooperation between IMF members under current-account convertibility of the dollar.

Effects on United States Balance of Payments

Operating in foreign currencies rather than gold would not in itself eliminate deficits in the balance of payments of the United States. Corresponding (European) balance-of-payments surpluses could continue to provide "excess" dollar holdings. A surplus country, say, France, holding excess dollars could (a) present them directly to the Federal Reserve in exchange for francs on demand (the conversion, of course, could still be to gold, but only at United States discretion); or (b) use the excess dollars to purchase some other foreign currency, say, German marks. Of course, France might also purchase gold from the free market, but only if the price were within the limits of the prescribed margins. As will be discussed below, no IMF member would be *obligated* to maintain the gold price. Accordingly, the price could be higher (or lower) than the limits within which gold can legally be purchased or sold by IMF members.¹

¹ Article IV(2) provides that "The Fund shall prescribe a margin above and below par value for transactions in gold by members, and no member shall buy gold at a price above par value plus the prescribed margin, or sell gold at a price below par value minus the prescribed margin." This theoretically allows countries to sell gold at a price higher than determined by the margin, or to buy it at less than the lower limit of the margin. However, the Fund is opposed to such transactions. Article IV(4)(a) requires members "to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations." This provision has been interpreted by the Fund as the legal basis for a statement

If France chose (a), and if the United States had the francs, international liquidity would be extinguished: United States reserves (francs) and French reserves (dollars) would both decline. (Under the present system, only the former decline: French reserves simply change in composition as between dollars and gold.) If the United States drew the francs from the IMF, France would then, in effect, have traded dollar reserves for a corresponding claim on the IMF, as happens today in such cases. If France chose (b), the marks could be purchased on the foreign-exchange markets in exchange for excess dollars. (No central bank would be obligated to convert dollars to marks on the direct demand of the French central bank, but the German and American central banks would be obligated to support mark-dollar exchange rates on the foreign-exchange markets within their territories.) The total process involving the disposition of excess dollars under current-account convertibility could therefore involve some further increases in foreign official holdings of dollars and claims on the IMF, along with some further depletion of United States foreign reserves, including currencies, drawings on the IMF, sales of gold by the U.S. Treasury (to obtain needed foreign currencies), special arrangements to borrow, and so forth.

It would appear, therefore, that switching to the market support of exchange rates between the dollar and foreign currencies would leave the United States fundamentally in the same position as it occupies today. This is true, however, only with respect to the fact that a given deficit in the United States balance of payments would continue to require financing. In fact, the balance-of-payments problem of the United States would tend to ease as a result of the following considerations:

1. Foreign countries would lose the right they now have of *demanding* conversion of excess dollars into U.S. Treasury gold. Countries henceforth would have to accept their own currencies, if offered, rather than only gold. Under current arrangements the United States, even when it has a deficit in its balance of payments, cannot legally compel any country to sell gold to it in exchange for that country's currency; whereas other countries, even with surpluses in their external payments, can compel the United States to sell gold freely in exchange for dollars.

issued to members on June 18, 1947 to prevent sales of gold at premium prices. In that statement the Fund deprecated the practice of transacting in gold "at prices substantially above monetary parity," and noted its "considered opinion" that "exchange stability may be undermined by continued and increasing external purchases and sales of gold at prices which directly produce exchange transactions at depreciated rates." (Statement reprinted in the *IMF Annual Report* for the year ending June 30, 1947, pp. 78-9. See also the *Annual Report* for 1948, pp. 39-44, for further expansion of the Fund's position on gold transactions outside the margins.)

Thus the demand for gold from the United States tends to constitute a one-way drain. By changing the United States obligation under the Articles to current-account convertibility, further demands for conversion of dollars, say, by France, could be met by payment of francs to France—thus extinguishing French monetary liabilities, rather than maintaining French official reserves. Or, if the United States drew francs from the Fund, such demands could simply result in an increased (gold-value-guaranteed, noninterest-bearing) French claim on the IMF. To the extent that the current policy of some countries reflects a powerful appetite for gold *per se*, the loss of the available option for gold might mitigate the strength of forces which tend to produce payments surpluses in such countries. In addition, there might be increased interest in maintaining reserves in interest-bearing dollar claims.

This result might be reinforced if the United States converted much of its gold into interest-bearing foreign assets, or used its gold to retire outstanding foreign official balances of interest-bearing dollar claims. It might be noted in this connection that the loss to the United States balance of payments from foregone interest on its \$13 billion gold stock (or interest paid out on dollar debt held abroad that otherwise would not exist), at, say, a 5 per cent interest rate, amounts to \$650 million per year. In addition, if the United States decided that it would sell gold in the future (to acquire needed foreign currencies) only to the IMF, the effect might be not only further to reinforce foreign interest in maintaining dollar reserves, but also to mitigate the problem of possible invidious comparisons between IMF member countries, with the United States transferring gold to some countries and not to others. (Some working balances in gold might be maintained for international settlements with non-IMF member countries.)

2. Under current-account convertibility of the dollar, IMF members would become legally subject to an obligation under the IMF Articles of making a representation when requesting dollar conversion (into gold or their own national currency) (VIII-4-a). There are two alternative representations, either one of which would satisfy the requesting country's obligation: (a) that the conversion was needed for making payments for current transactions; or, (b) that the dollars were recently acquired as a result of current transactions. This obligation does not now apply to requests for dollar conversion, since the dollar, the only currency *freely* exchangeable on demand for gold, must be converted without limitation on demand of central banks (IV-4-b, second sentence).

Although the requirement for representations under current-account convertibility might tend to reduce the attractiveness of dollars for

continued accumulation as an international reserve asset, the reduction is more apparent than real. Firstly, the representation that the conversion is needed for *current* transactions has not been, and probably cannot be, literally enforced. Instead, the phrase has been taken to indicate broadly that conversion will not be effected except in the event of a balance-of-payments need, that is, the existence of a balance-of-payments deficit. Accordingly, the principal function of the dollar as an international reserve asset would be preserved. Secondly, the representation that the dollars were acquired as a result of current transactions has generally been interpreted broadly, that is, primarily in the sense of timing or "currentness" (for instance, to stabilize outstanding sterling balances), rather than with respect to discrimination between current-account and capital-account transactions. There would be no requirement for the United States to enforce a system of capital controls, or to impose any distinction between current and capital transactions in meeting demands by countries for dollar conversion. It may be noted, in this connection, that the Fund has made no formal interpretation as to the nature of the alternative representations stipulated under Article VIII(4)(a) for effecting the convertibility of balances of a currency. The fact that no formal Fund ruling has ever been necessary is further evidence of the broad interpretation members have given to their legal requirements for maintaining the convertibility of their currency.

Accordingly, current-account-convertibility status for the dollar would obligate countries requesting dollar conversion to make one of the above representations, but this does not mean that the United States would actively enforce this obligation. The fact that the obligations under VIII(4)(a) would now apply to the dollar, as they already apply to all other convertible currencies, does not ensure that countries necessarily would comply. However, the stability of the international monetary system depends primarily on the voluntary cooperation of participating countries, rather than on enforcement. Current-account-convertibility status for the dollar would legally commit countries to rules of the game that are more explicit than under the present arrangements. The test of whether countries demanding dollar conversion were, in fact, complying with the rules would be clearer both to them and to the United States. Having explicitly defined what their responsibilities were, countries might well cooperate more fully.

As a technical matter, it may be noted that the fact that the dollar is an international currency means that dollars can generally be used by a country to finance a payments deficit without having to go through prior conversion. (An exception might arise, perhaps, in financing a payments

deficit with a country outside the IMF—say, Switzerland, or Soviet Bloc countries.) Accordingly, the conversion of dollars to meet a balance-of-payments need—alternative representation (a), see p. 8 above—generally would not be operative. However (surplus) countries receiving the dollars could, of course, convert them under alternative representation (b).

3. In the event that the Fund ran low on a particular national currency needed by the United States to meet demands for dollar conversion, the Fund could purchase such currency from the appropriate country, on demand, for gold, or, on agreement of the country, borrow the currency (Article VII, Section 2). Thus, demands for conversion of dollars could produce a drain on gold of the IMF, rather than on gold of the U.S. Treasury. However, in the event that the Fund considered it necessary to preserve its existing gold stock, it, rather than the United States, would have to enter into direct loan negotiations with the appropriate surplus country to borrow the needed national currency.

It is important to note that the Fund could not properly act to borrow a needed national currency unless its holdings of the currency were low, or there were a threatened scarcity. The possibility of intransigence by a surplus country regarding the adoption of policies conducive to correction of a payments imbalance, or at least for the provision of adequate capital exports (for example, lending additional national currency to the Fund), would thus become a matter of direct international concern through the Fund, rather than merely a matter of concern to the United States. In these circumstances, it is not inconceivable that the so-called "scarce-currency provisions" of the Fund (Article VII-3-b)—which were regarded as an essential element in the Bretton Woods system by both Keynes and White—would ultimately emerge as a potent instrument for a more equitable sharing of the burden of balance-of-payments adjustment. These provisions were intended as a means of balancing the penalties contained in the IMF Articles for applying pressure on countries that were persistent debtors to the Fund (deficit countries) by also providing penalties for countries that were persistent reserve hoarders (surplus countries). A formal finding by the Fund that a currency is scarce would authorize other members to impose reasonable exchange restrictions against transactions in the scarce currency as long as the condition lasted. At minimum, the threat of the scarce-currency provisions—which are now a dead letter—would become less remote if for no other reason than the fact that the Fund would now be more directly affected by the balance-of-payments policies of its members. The scarce-currency provisions of the Articles have not ceased to exist simply because they have been ignored. The fact of their existence should strengthen the Fund's bargaining position in negotiations for loans.

The cost of accomplishing the above would include the following items:

1. A loss of United States prestige. The United States would no longer derive psychological returns as the only country whose currency is freely convertible to gold.

2. An increase of IMF power. The United States would depend increasingly on IMF policies concerning the availability of liquidity to the United States for balance-of-payments financing, and IMF policies toward those countries whose currencies would be drawn from the Fund.

3. The danger of a reduced willingness of countries to hold dollars no longer freely convertible to gold. However, as noted above, the United States would receive some protection against large-scale demands for conversion of outstanding dollar-reserve balances which is not presently available to the dollar as a currency freely exchangeable for gold. Thus the safeguards provided by current-account convertibility, as they apply to all other so-called convertible currencies, would now also apply to the U.S. dollar. (There are various other protections not discussed. For example, see VIII-4-b-iv in the Appendix.)

4. Important cost implications concerning a shift of power from the United States to the international monetary community. These will be discussed in the final section of this essay.

Effects on the Role of Gold

Adopting current-account convertibility for the dollar would diminish the closeness of the present link between the dollar and gold in the international monetary system, but would not eliminate it. Under the present system, countries can obtain gold in exchange for dollars, or dollars in exchange for gold, from the United States on demand at the fixed price of \$35.00 (neglecting service charges), and the United States is committed to act as residual buyer or seller of gold. With current-account convertibility, no such obligatory facility would exist. Countries might still buy gold, provided the price were within the margins prescribed by the Fund, but there would be no country obligated to sell it. Countries could also sell gold, provided the price were within the prescribed margins, but there would be no country obligated to buy it. (See discussion of Article IV[2] and Fund policy interpretations in footnote 1 above.)

Current-account convertibility for the dollar would tend to activate the Fund to perform part of the function now being executed by the United States as residual buyer and seller of gold. Although no *member country* could legally be compelled to purchase gold from another mem-

ber, the *Fund* would be obligated to buy gold when presented to it by any member.² Fund members also would remain obligated to buy gold from the Fund in exchange for their own currencies on the demand of the Fund (Article VII[2][ii]).

The above provisions, taken together, constitute an international monetary structure, in which the basic elements provide that members may, *at their option*, buy and sell gold in exchange for currencies *among themselves*—at prices bound by defined currency parities plus or minus margins specified by the Fund—with the Fund *obligated* to buy gold at par on the demand of members, and members *obligated* to buy gold at par on the demand of the Fund. The system implies the following conclusions with respect to gold prices, gold flows, and exchange rates:

1. Gold would remain an important international monetary medium, as IMF members could convert it on demand into currencies at the Fund at parity, and the Fund could, if needed, likewise convert gold into member currencies on its demand. The gold-convertibility function of the Fund would differ from that now being performed by the U.S. Treasury primarily in that the Fund, unlike the United States under its present unilateral policy, could not be compelled to buy currency (sell gold) on the demand of its members. Members could obtain gold from the Fund only at the Fund's initiative (a Fund purchase of currency). In this respect the link between gold and national currencies would take on the somewhat more limited degree of convertibility envisaged by Keynes for the "bancor"—countries could buy bancor from the Fund for gold, but not vice versa. By way of contrast, the current degree of convertibility between gold and the dollar corresponds with that envisaged by White for the "unitas."

2. Since the Fund and member countries would be committed to support the gold price only with respect to transactions between themselves, the world market price for private transactions in gold could conceivably float without limit. However, countries desiring to regulate the gold market price, say by preventing it from exceeding the upper margin prescribed by the Fund, could sell gold freely at their option at a price no higher than parity plus the margin. Thus the upper limit of the price of gold—now maintained primarily through free sales of gold by the U.S. Treasury—would or would not be maintained, depending on the strength of the combination of countries desiring to maintain it. If coun-

² Article V(6) (a). "Any member desiring to obtain, directly, or indirectly, the currency of another member for gold shall, provided that it can do so with equal advantage, acquire it by the sale of gold to the Fund." The "equal advantage" provision is intended to avoid penalty to a member by requiring that it purchase currency from the Fund even when (legally) possible to obtain it elsewhere at a lower cost.

tries holding large gold stocks desired to maintain the price of gold in terms of their own currency within the prescribed margins, nothing would prevent their doing so by selling gold up to the physical limitation of their gold stocks. The more widespread the international agreement to maintain the gold price within the margins now prescribed by the Fund, the less restricting this physical limitation becomes. Thus, the price of gold in the private market would remain fixed or not, depending on the size of the combined monetary gold stock of the group of IMF members desiring to fix the gold price, and the responsibility would be shared collectively, rather than being borne almost exclusively by the United States, as at present. There can be no doubt that the huge stocks of monetary gold now in the hands of world monetary authorities could maintain the present \$35.00 gold price indefinitely, if that were the world's choice.

(Under the present London Gold Pool arrangement, the United States has a 50 per cent participation in gold-dollar-support operations. However, other participating countries can, and sometimes do, reverse the effects of gold losses through the Pool by bilateral official dollar conversions with the United States, in which case the United States, in reality, is the full residual supplier of gold to the London market.)

3. IMF members preferring to allow the price of gold to float in terms of their currencies could do so. (But, under existing IMF interpretations and policies, they could not legally sell gold at premium prices or buy it at bargain prices even though the Articles do not explicitly rule out such transactions.) International currency arbitrage, however, would tend to maintain world uniformity of the private price of gold in terms of all member currencies.

4. As mentioned previously, all countries would continue to be obligated to support the currencies of members within their territories at (fixed) exchange rates determined by their defined parities plus or minus one per cent. Thus, if gold prices were permitted to float outside the prescribed margins and, in fact, did so, gold transactions could be carried on domestically and internationally between private individuals or firms, but IMF members (official authorities) could not be a party to the transaction. International arbitrage in gold would then operate in such a way as to tend to make the world market price of gold, although outside the margin, nevertheless uniform in terms of all member currencies. In the absence of gold-market operations by monetary authorities within the prescribed margins, the world market price of gold would, of course, reflect the forces of private supply and demand.

5. If countries (holding large gold stocks) decided against maintaining the price of gold within the prescribed margins, and if the price then

moved either above or below the margins and remained there, the total monetary gold stock of the Free World (IMF members plus the Fund itself) would freeze. Gold transactions between members, or between private individuals and a member, would not be permitted at prices outside the margins. Shifts of gold between a member and the Fund could, of course, occur, at prices within the prescribed margins, but the total official monetary gold stock of the system as a whole would not change. (This assumes no change in Fund policies concerning sales of gold at premium prices and purchases of gold below the lower limit of the margin. It is, of course, conceivable that under the new circumstances the Fund would revise these policies, say, to permit either losses or gains in the stock of monetary gold.)

6. In view of the fact that the Fund would remain obligated under the Articles to purchase at par (neglecting service charges) all gold presented to it on the demand of its members for currencies, a member could prevent the market price of gold from falling below the lower limit of the margins by buying gold from the market (say, at the lower limit of the margin), and then selling it at par to the Fund. If there were a massive unloading of gold, however, countries might not be able to prevent the price of gold from declining below the lower limit of the margins.

7. If the gold price on world markets should ever settle below the margin, the gold held by the monetary authorities of the system would still be convertible at the fixed-parity price of currencies at the Fund. However, in case of such a decline in the world market price for gold, the possibility of a uniform official reduction in the price of gold (appreciation of currencies in terms of gold) becomes an increased risk. It is conceivable that such a threat could lead Fund members to unload monetary gold on the Fund in exchange for currencies at par. However, the build-up of gold holdings by the Fund is limited by the provision that members cannot legally purchase gold from the market at prices below parity minus the margin (again, assuming no change in Fund gold policies).

(The actual process could produce an indeterminacy. Member countries might buy currencies from the Fund for gold, but as Fund currency supplies ran low, the Fund would sell gold to members for needed currency. The result is a merry-go-round, with the Fund selling gold to members for needed currencies, and the members doing vice versa. Thus, stability of the international monetary system is again shown to depend on international cooperation, without which no international monetary system can operate satisfactorily.)

8. In the (more likely) event that, at least initially, the market price of gold rose above parity plus the margin, there would be the opposite

threat of a uniform increase in the price of gold. Once again, however, there could be no reduction in the combined monetary gold stock, as IMF members could not buy gold (at parity) from the Fund on demand (in order to sell it to the market at premium prices). The threat of a possible increase in the official price of gold might, of course, grow in the event of premium gold prices on the free market. The ultimate responsibility for such an increase, however, would be borne collectively by the whole membership of the IMF, rather than almost exclusively by the United States, as in the present situation. It is clear that, as a practical matter, a uniform increase (decrease) in the price of gold would remain difficult to accomplish. However, the shift of responsibility to an international consensus for any action in this area would tend somewhat to diminish, as well as to re-route, the direction of any international outcry such action might provoke.

Summary and Conclusion

In summary, then, current-account convertibility for the dollar would significantly change the role of the U.S. Treasury in the international monetary system, but would not in itself eliminate, or necessarily even change the role of gold. Gold would remain convertible at par with the IMF, and its price in the world market would either be determined by forces of supply and demand, or else be pegged, as now, within the prescribed margins, depending on the collective decision of the international monetary community. More importantly, exchange rates with respect to national currencies would remain fixed within one per cent margins.

The official gold parity of the dollar would not be modified as a consequence of adopting current-account convertibility and, although the market price of gold might change, official holders of gold would still be legally entitled to conversion at parity (at the Fund). Although monetary authorities who hold primarily dollars could not secure gold on demand (unless the market price were within the margins), neither could official holders of gold make windfall gains from sales at prices above the margin. Thus, countries that maintain dollar reserve balances (rather than gold) would not be penalized, gold-hoarding countries could not legally benefit from sales at prices above par (according to existing Fund interpretations), and the United States, therefore, would not have violated any moral commitment to countries holding dollars. In addition, such action by the United States would be entirely consistent with the provisions of the IMF Articles of Agreement.

The United States would continue to be subject to the necessity of having to finance its balance-of-payments deficits. However, the addi-

tional burdens and responsibilities imposed on it under the present relationship between the dollar and gold would be made more comparable to those imposed on other countries.

Making the present or any other international monetary system work satisfactorily requires international cooperation. If there were sufficient cooperation between major countries, the limited supply of gold and the unique United States commitment to dollar-gold convertibility would present no particular problem. However, a political rift has developed between the United States and Continental Europe which has led to persistent drains of gold from the U.S. Treasury. It is clear that this drain cannot go on indefinitely, and that some corrective action is necessary. So far, such action has largely taken the form of ever-increasing limitations and controls on international official transactions and private capital flows, with more restrictions, not less, in store.

National political differences have prevented the reaching of an agreement on a *major* reform of the international monetary system. Although there may be a new facility for creating international liquidity, the amounts provided are likely to be only minimal. This seems virtually assured by the strong veto power that the EEC bloc has insisted upon. In addition, there has been no consideration of the need to restore balance to the monetary system by applying to reserve hoarders the same degree of pressure for payments adjustment as is applied to deficit countries. Under these circumstances, it seems reasonable to expect through time a continued loss of gold by the U.S. Treasury and a further proliferation of restrictions and controls. There is, therefore, a strong possibility that a radical change in the international monetary system may be the only logical end to the present course of events.

The analysis of the effects of changing to current-account convertibility for the dollar has shown technical losses as well as gains. On the minus side, for example, the system is overly defined: n national currencies require but $n-1$ central banks engaging in market intervention to maintain exchange parities within the one per cent margins. Instead, n central banks would be doing it. This makes for an untidy situation, but one that would not be unsolvable. Indeed, a solution derived within a multilateral framework—in cooperation with the Fund—suggests itself. Article IV (4)(a) obligates members “to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations.” This provision, though already important, might well become even more significant. It could pave the way to elimination of the need for the multitude of bilateral negotiations now required in establishing bilateral swaps between the Federal Reserve and foreign central banks. On the clearly positive

side, there would be more explicit rules of the game concerning the appropriate timing for requests for dollar conversion, and the possibility of returning to the provisions of the Articles for applying more balanced pressures against surplus and deficit countries alike to take appropriate action to eliminate their external imbalances. These technical changes in the structure of the international monetary system—like those of the proposed new liquidity-creating facility, and other technical proposals on today's scene—would, in themselves, neither save the system nor bury it. The real problem is not with the system, but with the players.

The most important effect of changing to current-account convertibility for the dollar would not be technical, but political. The United States would give up some of the enormous sovereign power it now wields alone in deciding for the world what the function and value of gold should be. This would represent a form of political capitulation to General de Gaulle, as the dollar would become more like the franc with respect to its relation to gold and the international monetary system. Such a capitulation clearly represents a cost to the United States. Whether it should pay the price depends on what it would get in return. The technical net improvement of the international monetary system, as analyzed in this essay, might not be so attractive, as such, to decide the issue. As usual, we should not expect more of a real improvement from technical change than we have learned to expect from past experience. All proposed schemes involve some pluses and some minuses, not to mention even great risks—for instance, the creation of "paper gold" or new drawing facilities could to some extent displace, rather than supplement, dollars as an international reserve asset.

The most important gain to the United States for capitulating on gold would be a reduction in her burden of world responsibility. The reduction would not be total. The United States would still have considerable influence in the international monetary power structure—more than any other country. But other countries would gain additional power—and responsibility—for determining the role of gold in the international monetary system. The agency through which this power would be wielded would be the IMF.

The principal effect of this leveling of the international monetary power structure is that *any* decision to reform the system significantly would become less radical. Every country would be more intimately involved in major decisions. The international monetary community of nations—rather than only the United States through unilateral action—would bear responsibility for the effects of such decisions.

By the adoption of current-account convertibility of the dollar, there would no longer be any country committed to maintaining a fixed price

of gold. Thus the United States would be depositing the issue of what should be done about the role of gold into the collective lap of the IMF. Whether the present close link of gold to the dollar should be retained, or the margins widened, or the price of gold uniformly increased or allowed to vary could then be decided by an international consensus, and any change could be undertaken with a reduced threat of major international disturbance.

As mentioned previously, the existing convertibility link between gold and the dollar is as strong as envisaged by White for the unitas. Because of this, it was eventually seen that the function of the unitas would be essentially superfluous—little more than simply an international unit of account. Accordingly, the notion of the unitas was eliminated from the Bretton Woods system. Instead, the U.S. dollar would, in effect, be the world's unitas.

By changing to a current-account dollar, the role of gold in the international monetary system would move toward that envisaged by Keynes with respect to the bancor: Keynes had proposed an international institution that could adjust the supply of bancor in accordance with the world's needs for international liquidity. There are, of course, no bancor under today's IMF Articles, but the Fund does have the power to vary the level of the quotas of its members in accordance with world needs for liquidity. A current-account dollar would be a partial step in the direction of Keynes' concept for the international monetary system. Through time, it might be expected that countries would transfer increasing amounts of gold to the Fund in exchange for foreign currencies. The power once wielded by the United States when it held almost all the world's monetary gold thus would tend to shift to the Fund.

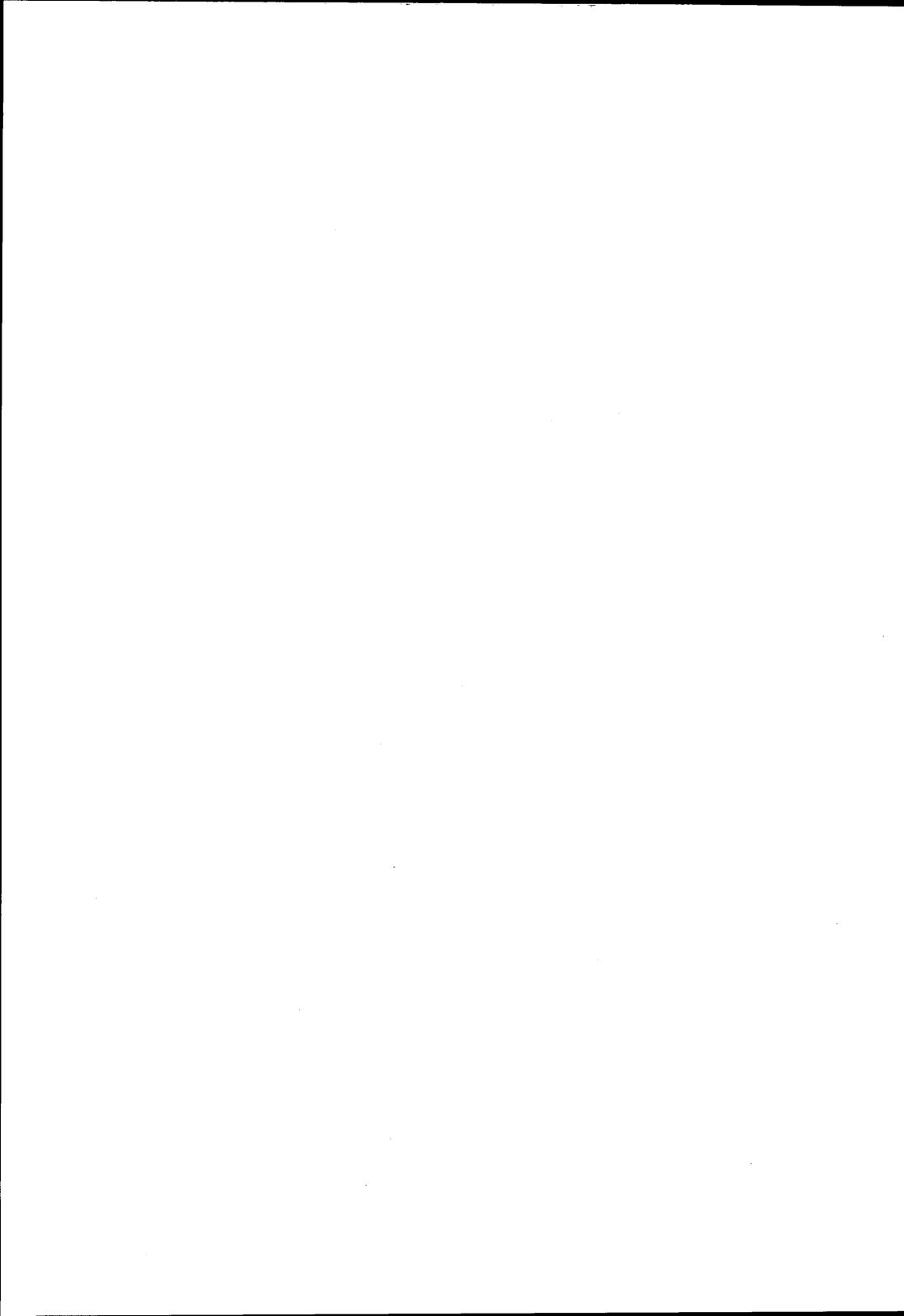
The fact that adopting current-account convertibility would be entirely legal is also very important. The United States, as the most powerful nation on earth, must exert its leadership in accordance with the law.

In determining whether to take this or some other step, the United States must determine the pros and cons, and then choose the policy approach that is least inconsistent with the attainment of all its major domestic and foreign policy objectives. An important question to be decided is whether the United States should act to delegate substantial power to an international consensus as the eventual center of the international monetary system. The International Monetary Fund would be the institution at the center of the system. Within that forum the United States can greatly influence, but not control, what is decided.

Although Europe might like certain aspects of moving to current-account convertibility of the dollar, other aspects may tend to widen further the gulf between the United States and its European allies. On

the other hand, this risk remains no matter what policy the United States adopts.

It should be recognized that every action or lack of action by the United States, including the maintenance of the present close link between the dollar and gold, the shift to current-account convertibility for the dollar, unilaterally floating the dollar, or increasing the price of gold, jeopardizes the attainment of some aims while achieving others. Thus any so-called solution to the United States payments problem, or to the problems of the international monetary system, can be only relative—having a cost in terms of the failure to achieve other major domestic or foreign objectives. The trade-off between competing risks, objectives, and costs must be thoroughly analyzed, and the choices made in the light of these alternatives.



APPENDIX: SELECTIONS FROM THE TEXT OF THE ARTICLES OF AGREEMENT OF THE INTERNATIONAL MONETARY FUND

The governments on whose behalf the present Agreement is signed agree as follows:

INTRODUCTORY ARTICLE

The International Monetary Fund is established and shall operate in accordance with the following provisions:

ARTICLE I—PURPOSES

The purposes of the International Monetary Fund are:

- (iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

ARTICLE IV—PAR VALUES OF CURRENCIES

Section 1. Expression of par values—(a) The par value of the currency of each member shall be expressed in terms of gold as a common denominator or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944.

(b) All computations relating to currencies of members for the purpose of applying the provisions of this Agreement shall be on the basis of their par values.

Section 2. Gold purchases based on par values—The Fund shall prescribe a margin above and below par value for transactions in gold by members, and no member shall buy gold at a price above par value plus the prescribed margin, or sell gold at a price below par value minus the prescribed margin.

Section 3. Foreign exchange dealings based on parity—The maximum and the minimum rates for exchange transactions between the currencies of members taking place within their territories shall not differ from parity—

- (i) in the case of spot exchange transactions, by more than one per cent; and
- (ii) in the case of other exchange transactions, by a margin which exceeds the margin for spot exchange transactions by more than the Fund considers reasonable.

Section 4. Obligations regarding exchange stability—(a) Each mem-

ber undertakes to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations.

(b) Each member undertakes, through appropriate measures consistent with this Agreement, to permit within its territories exchange transactions between its currency and the currencies of other members only within the limits prescribed under Section 3 of this Article. A member whose monetary authorities, for the settlement of international transactions, in fact freely buy and sell gold within the limits prescribed by the Fund under Section 2 of this Article shall be deemed to be fulfilling this undertaking.

ARTICLE V—TRANSACTIONS WITH THE FUND

Section 3. Conditions governing use of the Fund's resources—(a) A member shall be entitled to buy the currency of another member from the Fund in exchange for its own currency subject to the following conditions:

- (i) The member desiring to purchase the currency represents that it is presently needed for making in that currency payments which are consistent with the provisions of this Agreement;

Section 6. Purchases of currencies from the Fund for gold—(a) Any member desiring to obtain, directly, or indirectly, the currency of another member for gold shall, provided that it can do so with equal advantage, acquire it by the sale of gold to the Fund.

ARTICLE VI—CAPITAL TRANSFERS

Section 3. Controls of capital transfers—Members may exercise such controls as are necessary to regulate international capital movements, but no member may exercise these controls in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments, except as provided in Article VII, Section 3(b), and in Article XIV, Section 2.

ARTICLE VII—SCARCE CURRENCIES

Section 1. General scarcity of currency—If the Fund finds that a general scarcity of a particular currency is developing, the Fund may so inform members and may issue a report setting forth the causes of the scarcity and containing recommendations designed to bring it to an end. A representative of the member whose currency is involved shall participate in the preparation of the report.

Section 2. Measures to replenish the Fund's holdings of scarce cur-

rencies—The Fund may, if it deems such action appropriate to replenish its holdings of any member's currency, take either or both of the following steps:

- (i) Propose to the member that, on terms and conditions agreed between the Fund and the member, the latter lend its currency to the Fund or that, with the approval of the member, the Fund borrow such currency from some other source either within or outside the territories of the member, but no member shall be under any obligation to make such loans to the Fund or to approve the borrowing of its currency by the Fund from any other source.
- (ii) Require the member to sell its currency to the Fund for gold.

Section 3. Scarcity of the Fund's holdings—(a) If it becomes evident to the Fund that the demand for a member's currency seriously threatens the Fund's ability to supply that currency, the Fund, whether or not it has issued a report under Section 1 of this Article, shall formally declare such currency scarce and shall thenceforth apportion its existing and accruing supply of the scarce currency with due regard to the relative needs of members, the general international economic situation, and any other pertinent considerations. The Fund shall also issue a report concerning its action.

(b) A formal declaration under (a) above shall operate as an authorization to any member, after consultation with the Fund, temporarily to impose limitations on the freedom of exchange operations in the scarce currency. Subject to the provisions of Article IV, Sections 3 and 4, the member shall have complete jurisdiction in determining the nature of such limitations, but they shall be no more restrictive than is necessary to limit the demand for the scarce currency to the supply held by, or accruing to, the member in question; and they shall be relaxed and removed as rapidly as conditions permit.

(c) The authorization under (b) above shall expire whenever the Fund formally declares the currency in question to be no longer scarce.

ARTICLE VIII—GENERAL OBLIGATIONS OF MEMBERS

Section 2. Avoidance of restrictions on current payments—(a) Subject to the provisions of Article VII, Section 3(b), and Article XIV, Section 2, no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions.

Section 4. Convertibility of foreign-held balances—(a) Each member shall buy balances of its currency held by another member if the latter, in requesting the purchase, represents—

- (i) that the balances to be bought have been recently acquired as a result of current transactions; or
- (ii) that their conversion is needed for making payments for current transactions.

The buying member shall have the option to pay either in the currency of the member making the request or in gold.

(b) The obligation in (a) above shall not apply—

- (i) when the convertibility of the balances has been restricted consistently with Section 2 of this Article, or Article VI, Section 3; or
- (ii) when the balances have accumulated as a result of transactions effected before the removal by a member of restrictions maintained or imposed under Article XIV, Section 2; or
- (iii) when the balances have been acquired contrary to the exchange regulations of the member which is asked to buy them; or
- (iv) when the currency of the member requesting the purchase has been declared scarce under Article VII, Section 3(a); or
- (v) when the member requested to make the purchase is for any reason not entitled to buy currencies of other members from the Fund for its own currency.

ARTICLE XIV—TRANSITIONAL PERIOD

Section 2. Exchange Restrictions—In the postwar transitional period members may, notwithstanding the provisions of any other articles of this Agreement, maintain and adapt to changing circumstances (and, in the case of members whose territories have been occupied by the enemy, introduce where necessary) restrictions on payments and transfers for current international transactions. Members shall, however, have continuous regard in their foreign exchange policies to the purposes of the Fund; and, as soon as conditions permit, they shall take all possible measures to develop such commercial and financial arrangements with other members as will facilitate international payments and the maintenance of exchange stability. In particular, members shall withdraw restrictions maintained or imposed under this section as soon as they are satisfied that they will be able, in the absence of such restrictions, to settle their balance of payments in a manner which will not unduly encumber their access to the resources of the Fund.

* * * * *

The following excerpt from the Rules and Regulations of the International Monetary Fund is also of importance to this essay:

F—PAR VALUES

F-4. For transactions in gold by a member the margin above and below par value shall be, at the option of the member, either:

1. One quarter of one per cent plus the following charges:
 - (a) The actual or computed cost of converting the gold transferred into good delivery bars at the normal center for dealing in gold of either the buying member or the member whose currency is exchanged for the gold;
 - (b) The actual or computed cost of transporting the gold transferred to the normal center for dealing in gold of either the buying member or the member whose currency is exchanged for the gold;
 - (c) Any charges made by the custodian of the gold transferred for effecting the transfer; or
2. One per cent, which one per cent shall be taken to include all of the charges set forth in 1 above.

SOURCES: *Legislation on Foreign Relations*, "International Monetary Fund: Articles of Agreement" (Washington, D.C.: January 21, 1966), pp. 565-582.

International Monetary Fund, *By Laws; Rules and Regulations* (Washington, D.C.: August 10, 1966), p. 23.

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AVAILABLE FROM PRINCETON UNIVERSITY PRESS

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