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THE INTERNATIONAL STATUS OF THE DOLLAR

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INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS AND SOCIOLOGY

PRINCETON UNIVERSITY

Princeton, New Jersey

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International Finance Section

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I. INTRODUCTION

A PROFOUND change has occurred in recent years in the international status of the dollar—a change of considerable significance for the international financial mechanism and of wide implications for the foreign financial relations of the United States.

Foreign short-term dollar assets* have surged from less than $5 billion at the end of 1947 to an all-time peak of $13.4 billion at the end of 1956 and, as Chart I shows, are now close to the amount of foreign gold reserves. Approximately $8 billion of the total foreign short-term holdings were in the accounts of central banks and other monetary authorities abroad at the 1956 year end; $3.4 billion were held by commercial and other foreign banks; and about $2 billion were owned by private foreign interests. The striking increase and the unprecedented level of foreign short-term dollar assets reflects, of course, the continuous cash surpluses during recent years in the balance of payments of the rest of the world vis-à-vis the United States. But foreign dollar gains—to the extent that they accrue to monetary authorities—may generally be employed for acquiring gold from the United States Treasury. Yet actually they were so used only in the very modest amount of $1.2 billion net during the 1948-1956 period. Foreign central banks and other monetary authorities as a whole have preferred to add the great bulk of their net dollar acquisitions to their dollar reserves. The in-

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* The term "foreign short-term dollar assets" will be used throughout this essay to comprise demand and time deposits, United States Treasury bills and certificates of indebtedness, and other assets having an original maturity of less than one year such as acceptances, commercial paper, etc., held by foreigners in United States banking institutions. *These totals do not include the dollar assets of international institutions*, except those of the Bank for International Settlements. All statistics in this essay relating to these assets are taken from the United States *Treasury Bulletin*.

In addition to short-term dollar assets as here defined, foreign monetary authorities and other foreign entities, primarily insurance companies, held on December 31, 1956 approximately $1.1 billion worth of United States Treasury notes and bonds, a substantial proportion of which was maturing within relatively short periods and was therefore almost as liquid as assets defined here as short-term.

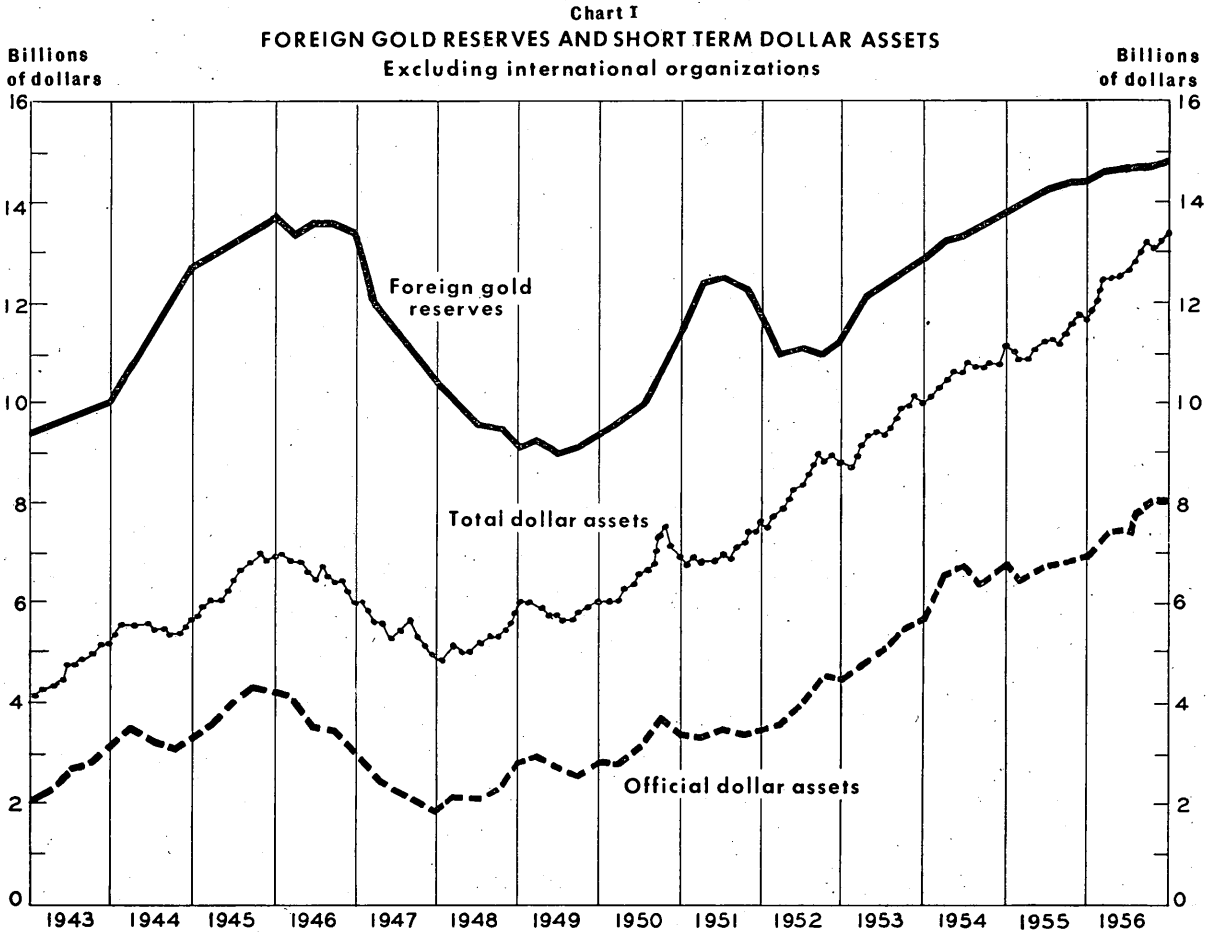
Chart I
FOREIGN GOLD RESERVES AND SHORT TERM DOLLAR ASSETS
Excluding international organizations
Billions of dollars
Billions of dollars
16
14
12
10
8
6
4
2
0
Foreign gold reserves
Total dollar assets
Official dollar assets
1943
1944
1945
1946
1947
1948
1949
1950
1951
1952
1953
1954
1955
1956

crease in foreign short-term dollar assets thus affords clear evidence of the fact that numerous central banks are finding dollar assets increasingly attractive relative to gold as an *international store of value.* Several such banks now keep their international monetary reserves largely—and in a few cases almost entirely—in the form of dollar assets rather than in the form of gold. At the same time, the rise in holdings of central banks, and perhaps to an even greater degree those of foreign commercial banks and other private owners, may be attributed to the increasing use of the dollar as a *means of international settlement,* a function in which the dollar has become increasingly important not only relative to gold, but also relative to sterling to some extent. In short, a large number of countries are now on what may be called the dollar exchange standard.

Much of the significance for the international financial mechanism of the $6.2 billion rise of foreign official dollar assets during the 1948-1956 period derives from the fact that it has augmented materially the world's monetary reserves. Had foreign countries not made use of dollar assets as an international store of value on such a large scale, we might now be witnessing a general shortage of monetary reserves relative to the rapidly growing need for them resulting from the very sizable expansion in world trade and payments. One way of assessing the important contribution of the dollar exchange standard as an economizer of gold, is to visualize the impact on the United States gold stock, and on international monetary reserves as a whole, had foreign central banks as a group chosen to utilize *all* their net dollar acquisitions since 1948 for purchasing gold from the United States Treasury. In that case, our own gold reserve would have fallen considerably and the increase in aggregate monetary reserves of the world would have been substantially less. It is conceivable, moreover, that such a loss in our own reserves might have led to revisions in our international economic policies of a sort designed to cut down the size of our cash balance-of-payments deficit with foreign countries.

While the impressive rise in foreign official dollar holdings has thus served to add substantially to the aggregate of international monetary reserves, it has also meant an equivalent increase in the potential claims on the United States gold stock. It is this aspect of the dollar exchange standard in particular that has attracted lately a great deal of attention and comment. Much has been made of the fact that our so-called "free" gold reserve—that is, our total gold stock less the amount of gold certificates required as "cover" for Federal Reserve note and deposit liabilities—has since 1953 been below our aggregate short-term dollar liabilities. But our *total* gold stock has remained far in excess of these latter liabilities, and our "free" gold is substantially above dollar assets immediately convertible into United States Treasury gold, i.e., short-term dollar assets held by foreign monetary authorities. It is one of the contentions of this essay that the marked decline, relative to foreign short-term dollar holdings, of our total gold and of our "free" gold gives no cause for alarm, considering the exceedingly strong international economic position and the basic financial strength of this country. There does not appear to be any good reason at this time to doubt the ability of the United States to meet all possible claims on its gold.

The existence of a big and continuously growing mass of foreign-held dollar assets also has fairly important implications for our money market. Foreign central banks now hold a very sizable proportion of the total amount of Treasury bills outstanding and, together with private foreign banks, dominate the market for acceptances. In fact, the aggregate of foreign dollar assets is now so large that major shifts in the investment preferences of foreign banks, or shifts of deposits between the Federal Reserve Banks and the commercial banks, or conversions of foreign balances into gold and vice versa could cause large-scale disturbances in particular sectors of our money market. It is quite possible that at times the investment operations of foreign central banks may, unless offset, have effects quite contrary to our own monetary policy objectives, thereby complicating the task of domestic credit administration. The emergence of the dollar exchange standard thus raises important questions of how to reconcile the responsibilities of the United States as a pivot of the world's financial system with the requirements of domestic money market policies.

It is the purpose of this essay very briefly to review the changing international status of the dollar from the post-World War I days of the gold exchange standard through the period of the hot money movements of the 'thirties to the successive liquidation and accumulation of dollar assets since World War II; to survey the changing rôle of dollar assets in international monetary reserves relative to gold; to emphasize the basic facts regarding the current size, distribution, and categories of foreign short-term assets; and, finally, to draw attention to some of the emerging policy problems associated with the accumulation of foreign short-term dollar assets.

No attempt will be made here to explore some of the longer range issues that may affect the functioning of the dollar exchange standard in the years ahead. These fundamental questions relate to the problem of the international distribution of monetary reserves and the possible emergence of new reserve centers, as well as to the need for formulating "rules of the game" to assure the proper and smooth operation of the international monetary system. Some of these questions involve controversial problems that have not by any means been resolved from the standpoint of United States official policy. It is the hope of the author that this essay will facilitate and encourage further detailed analysis and discussion of these important policy matters.

II. THE INTERNATIONAL POSITION OF THE DOLLAR 1921-1947

Spectacular increases in foreign dollar holdings are by no means without historical precedent, though earlier foreign dollar accumulations, while sizable, were on a far smaller scale than those of recent years and occurred, moreover, largely in private rather than official accounts. Foreign dollar holdings rose rapidly in the early 'twenties when political disturbances and anticipated currency and exchange disorders made the United States an attractive haven for European flight capital. Heavy stock market speculation in the closing years of the decade brought large additional amounts of private funds to the United States. The so-called backwash of our heavy foreign lending in the 1920's also contributed to the holding of foreign dollars here as loan proceeds piled up pending their utilization.

To a considerable extent, however, the $2.5 billion increase in foreign balances during the period 1921-1929 reflected, not unlike the upsurge in more recent years, the emergence of the dollar as a major international reserve medium. In the 'twenties, a large number of countries shifted from the gold to the gold exchange standard, under which foreign central banks were permitted to include foreign exchange holdings in their currency cover. This tendency was encouraged by the then prevailing fear of a gold shortage. The monetary experts who met in Genoa in 1922 felt that the stabilization of currencies during the early postwar years on a gold basis would lead to a struggle for limited amounts of gold. The Genoa conference, therefore, put its official stamp of approval on the inclusion of foreign exchange in the monetary reserves of central banks.

Upon receiving official sanction for this practice, many central banks, especially those in Europe, invested an increasingly large proportion of their international monetary reserves in foreign money markets. As holders of foreign exchange and as investors in interest-earning assets abroad, central banks soon became alive to developments affecting the value and yield of their holdings, such as prospective changes in foreign exchange rates and changes in relative interest rate levels. It was, therefore, only natural that they were prone to switch their balances from one money market center to another in response to financial and political disturbances and shifts in interest rate differentials. The resulting erratic movements of official funds introduced an element of instability into the international monetary situation of the 'twenties and detracted a great deal from the usefulness of the gold exchange standard.

Another weakness of the gold exchange standard was attributed to the fact that the investment of international monetary reserves in foreign money markets often left the central banks in the recipient countries in the dark as to the actual magnitude of foreign funds in their markets and as to the terms and conditions on which these funds were held. Lack of knowledge of such holdings deprived these banks of information they needed for making proper monetary policy decisions. Some central banks remained unaware of the threat to their own reserves implied in the presence of these volatile funds in their market and of the need to take precautionary measures in anticipation of their withdrawal.

Much of the criticism of the gold exchange standard as practiced in the 'twenties focused on the alleged fact that it was a prime factor in producing inflationary phenomena.* In this connection it was argued that movements of gold, unless offset by changes in domestic assets of central banks, tended to have reciprocal effects, since monetary expansion in the country acquiring gold was counterbalanced by a more or less simultaneous contraction in the country losing it. On the other hand, under the gold exchange standard, unless foreign exchange was held in the form of deposits with a central bank, this reciprocal effect was lost; consequently, so the argument ran, the gold exchange standard permitted the building of a superstructure of credit in several countries based upon the same gold reserve. The question of whether the present dollar standard is in any respect superior to the gold exchange standard will be considered later in this essay.

The depreciation of sterling in 1931 and the subsequent devaluation of other major European currencies, as well as the devaluation of the dollar in 1934, dealt the gold exchange standard a heavy blow. The severe losses of some central banks, primarily on their sterling holdings, produced an atmosphere inhospitable to foreign exchange as a medium in which to hold the reserves of monetary authorities. Nearly all central banks shifted almost entirely to gold. In any case, surplus funds available for dollar investments by central banks were shrinking rapidly in the early 'thirties, first because of the deterioration in the balance of payments of the rest of the world vis-à-vis the United States following the onset of the world economic depression in 1930, and then because of speculative pressures in anticipation of a depreciation

* For comments on this argument see League of Nations, *International Currency Experience*, Princeton 1944, pp. 44 ff.

of the dollar. From the end of 1929 to the end of 1933, foreign dollar balances were drawn down sharply by $2.5 billion, approximately the same amount by which they had been increased during the preceding decade. By the end of 1933, aggregate foreign dollar balances had declined to about $500 million, or to minimum working levels.

Following the stabilization of the dollar in terms of gold in January 1934, a heavy and rapid rebuilding of dollar assets set in. In the period 1934-1940 inclusive, foreign dollar assets rose by no less than $3.4 billion. But this increase was of an entirely different nature from that of the more recent period, since it reflected essentially "autonomous" private transfers of "hot money" from Europe and was accompanied, and in fact made possible, by large gold exports to this country. During the past decade on the other hand, the build-up was largely of the "accommodating" variety. It reflected for the most part transfers out of domestic to foreign dollar accounts as a result of the large cash deficits in our balances of payments.

In the 'forties, the dollar fortunes of foreign monetary authorities improved and deteriorated successively, depending on whether or not their dollar earnings together with dollar aid receipts exceeded or lagged behind their purchases of munitions and foodstuffs in the war years, and of raw materials and foodstuffs in the early postwar years. In 1941 foreign monetary authorities were compelled to sell large amounts of gold to the United States Treasury, but beginning in 1942 Lend Lease aid more than sufficed to cover the dollar deficits of foreign countries, and foreign monetary authorities were able to add substantially to their dollar holdings which they then invested to a considerable extent in United States Treasury bills. With the sudden termination of Lend Lease after the war, and as a result of heavy dollar requirements of foreign countries, dollar balances of foreign monetary authorities in 1946 and 1947 had to be drawn down considerably, and heavy gold sales to the United States Treasury became necessary. The year 1947 saw foreign short-term dollar holdings reaching their postwar low of $4.8 billion; since then there has occurred an unprecedentedly large rise, carrying these assets to $8.9 billion by the end of 1952 and to more than $13 billion at the end of 1956.

III. THE RECENT INCREASE IN FOREIGN SHORT-TERM DOLLAR ASSETS

Official versus Private Holdings

The bulk of the dramatic rise of foreign short-term dollar assets between the beginning of 1948 and the end of 1956 was in the holdings of central banks and such other monetary authorities as stabilization funds and foreign exchange offices. Their holdings rose by $6.2 billion, whereas those of commercial banks and other private parties increased by only $2.4 billion. Year-by-year details of the rise are shown in Table I. It is well to note that in some years the changes in short-term holdings of official institutions have been affected by their gold transactions with the United States Treasury and their purchases and sales of United States Treasury notes and bonds, which are not included in the table.

TABLE I

Foreign Short-term Dollar Assets in United States Banks 1948-1956

(In millions of dollars)

End of year	*Official*	*Nonofficial*			*Grand total (excluding international holdings)*
		Commercial banks	*Others*	*Total nonofficial*	
1947	1,832.1			2,972.7	4,804.8
1948	2,836.3			2,947.0	5,783.3
1949	2,908.1			3,001.0	5,909.1
1950	3,620.3	2,058.2	1,393.5	3,451.7	7,072.0
1951	3,547.6	2,528.2	1,513.0	4,041.2	7,588.8
1952	4,654.2	2,575.3	1,670.3	4,245.6	8,899.8
1953	5,666.9	2,527.1	1,781.3	4,308.4	9,975.3
1954	6,774.0	2,536.0	1,799.4	4,335.4	11,109.4
1955	6,956.3	2,954.8	1,770.3	4,725.1	11,681.4
1956	8,031.9	3,419.3	1,980.5	5,399.8	13,431.7

Source: *United States Treasury Bulletin*, May 1951 through 1954, February 1955 through March 1957.

The much slower rate of growth of private holdings than of official balances is primarily due to the fact that commercial banks and other private holders commonly prefer, or are required, to sell their net dollar acquisitions to their central banks once their holdings reach the minimum magnitudes considered necessary for their current operations in the dollar area. Under the circumstances prevailing in the early post-war period, foreign exchange control authorities forced banks and other private holders to sell the major part of their dollar acquisitions to central banks, and this of course was an important factor in slowing down the growth of private holdings during that period. As the dollar position of foreign monetary authorities became more comfortable, private interests were increasingly permitted to add to their holdings in this country, if they cared to do so. But even today, a substantial part of bank and other private holdings remains subject to official control and disposition and is in a sense really part of official holdings. Official holdings might thus be considered to be larger than those shown in this table.

Some of the non-official holdings represent funds that are left in the United States for safekeeping purposes, but the bulk consists of operating balances or of assets that have to be held here to cover liabilities to American residents, such as reserves of insurance companies. Requirements of banks and business firms for working balances have greatly increased in recent years: United States foreign trade now plays a more dominant role in world trade than it had before the war; prices for many commodities are at record levels; businessmen and banks in many countries insist on being paid in dollars rather than in other currencies; and innumerable individual trade debts are settled through accounts in the United States, even though the underlying transactions themselves may never directly involve the United States.

To some extent the rise in foreign official dollar assets also is attributable to larger needs for operating balances and for meeting possible drains on dollar reserves. The European Payments Union defines its units of account in terms of dollars, and until recently at least the monthly EPU settlements were consummated through dollar accounts in New York. Under many payments agreements, credit and debit balances in excess of swing ceilings must be settled in United States dollars. And there is a natural tendency for foreign monetary authorities to build up dollar balances to meet dollar obligations to the International Monetary Fund and the International Bank, to United States Government agencies, and to United States private banking institutions.

Still and all, foreign monetary authorities do not require $8 billion or more for operating purposes. The major part of foreign official dollar assets clearly represents reserves of international purchasing power. Foreign central banks now regard the bulk of their dollar holdings in the same manner as their gold reserves; both are considered international stores of value. The rise of official and private dollar holdings thus reflects the fact that dollars now play for many foreign countries a dual role: the currency with which to make a large share of their international payments and the currency in which to hold a large, if not major, part of their monetary reserves.

Foreign Official Dollar Assets and Gold Holdings

The rapid increase in foreign official dollar holdings has been accompanied by a marked rise in the ratio of such holdings to foreign official gold reserves. As indicated in Table II, the ratio rose from a mere 17.7 per cent at the end of 1947 to more than 30 per cent three years later. It then increased further to more than 50 per cent at the end of 1956.

TABLE II

Foreign Official Gold and Short-term Dollar Holdings
(In millions of dollars)

Year end of	*Gold*[a]	*Short-term dollar assets*	*Dollar assets as percentage of gold*
1938	11,358	474	4.2
1947	10,326	1,832	17.7
1950	11,496	3,620	31.5
1953	12,887	5,667	44.0
1954	13,807	6,774	49.1
1955	14,439	6,956	48.2
1956	14,750	8,032	54.4

[a] Excluding holdings of Soviet Russia.
Sources: *International Financial Statistics*, International Monetary Fund, December 1954; *Federal Reserve Bulletin*, December 1951 and March 1957; *United States Treasury Bulletin*, March 1957.

Table II also shows that the rise in the ratio was the result of a more rapid increase in official dollar assets than of gold holdings, rather than of a decline in foreign gold holdings. Foreign countries as a group hold today more gold than they ever did and are still adding to their holdings. What we have been witnessing, then, is a relative, but not an absolute, decline in the attractiveness of gold to foreign monetary authorities.

The bulk of the increase in foreign official gold reserves has come from foreign gold production. In general, the proportion of newly-mined gold sold in recent years to private hoarders has declined and an increasing share of total gold production has accrued to official reserves. In fact, there is evidence that private holders have dishoarded some gold. Western European gold reserves have also been augmented slightly from sales of gold by Soviet Russia. Approximately $1.2 billion, or 27 per cent, of the rise in foreign gold reserves since the end of 1947 represents gold acquired from the United States Treasury. Foreign gold purchases from the Treasury were sizable in the early 'fifties, but since then have been relatively small. Modest purchases in 1956 were more than offset by foreign gold sales to the Treasury.

Inasmuch as foreign monetary authorities may generally convert their dollar holdings into gold by purchase from the United States Treasury (and, conversely, may convert their gold into dollars by sale to the