THE 1980 PER JACOBSSON LECTURE

Reflections on the International Monetary System

Guillaume Guindey
Charles A. Coombs

The Auditorium
Bank for International Settlements
Basle, Switzerland
Sunday, June 8, 1980

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FOREWORD

The 1980 Per Jacobsson Lecture meeting was held on Sunday, June 8, 1980 in Basle, Switzerland, in the Auditorium of the Bank for International Settlements. The lecture, entitled "Reflections on the International Monetary System," was delivered by Guillaume Guindey, former General Manager of the BIS. A commentary on the subject and on his paper was offered by Charles A. Coombs, former Senior Vice President of the Federal Reserve Bank of New York. William McChesney Martin, Chairman of the Per Jacobsson Foundation, presided over the meeting, the proceedings of which are presented in this publication.

The Per Jacobsson lectures, which are held annually, are sponsored by the Per Jacobsson Foundation. The Foundation was established in 1964 in honor of Per Jacobsson, the third Managing Director of the International Monetary Fund, to promote informed international discussion of current problems in the field of monetary affairs. Per Jacobsson had been associated with the BIS for almost a quarter of a century prior to joining the Fund and it was fitting, therefore, that this year's lecture meeting was held in Basle as part of the celebrations commemorating the fiftieth anniversary of the BIS. The first lecture of the series, in 1964, had also been held in Basle.

These lectures are published in English, French, and Spanish and are distributed by the Foundation without charge. Through the courtesy of other institutions, other language versions are also issued from time to time. Further information may be obtained from the Secretary of the Foundation.

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Opening Remarks

William McChesney Martin

It is my happy privilege to convene the seventeenth annual lecture meeting of the Per Jacobsson Foundation. I am very glad that one of our Honorary Chairmen, Marcus Wallenberg, is with us today. Our other Honorary Chairman, Eugene Black, was unable to attend but he sends his regards. Our President, Frank Southard, is here on the platform; he has been a tower of strength in organizing the work of this Foundation. Also with us is Erin Jucker-Fleetwood, the daughter of Per Jacobsson. Her biography of Per Jacobsson, published last year by Oxford University Press, has been very well received.

We have had a good year and I am pleased to report to you that the Foundation is financially sound and that it is actively carrying out the tasks it was set up to fulfill.

We are fortunate today to have the Rector of the University of Basle with us. This is the fifth meeting that we have had in Basle and we have always had close ties with the University. So I am pleased to introduce to you Dr. Frank Vischer, the Rector of the University of Basle.

Frank Vischer

Mr. Chairman, Ladies and Gentlemen: The Rector of our University is on many occasions asked to address gatherings such as this. But organizations making these requests often have only casual connections with the University and are reminded of the University chiefly when an address of welcome by the Rector is needed. That is not the case today. Today I am not fulfilling a duty, but indulging in a real pleasure. It is with great joy and enthusiasm that I open the Per Jacobsson lecture meeting of this year and I take this opportunity to welcome you on behalf of our University and to praise the close relationship the University has with the Bank for International Settlements.

This year the BIS celebrates its fiftieth anniversary. It is a great occasion for you and it is a great occasion for the community of Basle as well. If in our rather quiet city of Basle an international breeze is discernable, if the name of Basle is known outside the Regio Basiliensis, it is due to our industries, perhaps—at least I hope so—to our University, and certainly the BIS, the only important international organization in our canton. The University has close ties with the BIS—especially the University's Departments of Economics and Law. These ties are expressed in many ways—through personal interchanges and mutual cooperation, through gracious donations, and through the interest that the professors and students of our Departments of Economics and Law take in the activities of the BIS. The views of the BIS in matters of law and economics, both national and international, are always carefully listened to. For me, as a lawyer in the field of international law, the BIS is a subject of close study and interest, since it is one of those rare organizations that is truly international in nature. Therefore, I thank the officers and staff members of the BIS for their continued interest in the University.

This is the seventeenth annual Per Jacobsson lecture, and the fifth to be held in Basle. The last lecture given in Basle was by Guido Carli and had the title "Why Banks are Unpopular." I am afraid that at least in Switzerland banks have not become any more popular since. Today, Mr. Guillaume Guindey, a former General Manager of the BIS, will reflect on the international monetary system, a system that is certainly still in imbalance and very much in need of your support.

It is certainly appropriate to recall today the name of Per Jacobsson, who is honored by this lecture. The BIS was the organization to which Per Jacobsson devoted his unique talents for twenty-four years before he assumed his duties as Managing Director and Chairman of the Executive Board of the International Monetary Fund in 1956. Therefore, it is particularly appropriate that this year's Per Jacobsson lecture should be held in conjunction with the fiftieth anniversary celebrations of the BIS with which Per Jacobsson's name will always be associated.

Mr. Guindey will be shortly giving his lecture, entitled "Reflections on the International Monetary System." This subject is one which, I am sure, will draw fully on his long experience in monetary affairs and his pragmatic approach to monetary problems. Following the lecture, Mr. Charles A. Coombs, former Senior Vice President of the Federal Reserve Bank of New York, has kindly agreed to offer a commentary on the subject. I need hardly remind you that Mr. Coombs was a regular visitor to Basle for fifteen years until his retirement in 1975. In 1976 he published his book—*The Arena of International Finance*. Apart from the insight the book gives into the gold and foreign exchange markets of the 1960s and 1970s, it reminds us of the close association Mr. Coombs has had with Basle for many years.

Once again, ladies and gentlemen, I thank you for your kind attention—and thus the expression of your affinity to Basle and the University.

William McChesney Martin

Thank you, Dr. Vischer, for your gracious welcome.

Over the years, I had quite a number of talks with Per Jacobsson and one that I remember very well took place not too far from here when he was trying to explain certain things to me. The gist of it, as I remember, was that you can print all the money you want but you can't print capital; capital comes from savings and investment. I shall always remember that.

I have had very pleasant relations through the years with our first speaker, and I think we all know what a constructive and fine citizen he has been. Mr. Guillaume Guindey.

Guillaume Guindey

Thank you, Mr. Chairman, for your very kind words.

I would like to say that I consider it a great honor to be invited today to give this year's lecture. I have had a long career—a large part of it in the French Treasury in the difficult days when the French Government was not, to say the least, very stable. So, I had to serve under a number of Finance Ministers—more than ten, I think. They were men very different from one another. Finally, I came to the conclusion that they could be divided into two categories. There were ministers who used to call me on the telephone and say, "Mr. Guindey, I want to see you. Could you please come upstairs?" And there were those who used to call me on the telephone and say, "Mr. Guindey, I want to see you. Could you please come downstairs?" But no one, no one realized that I could not go upstairs and I could not come downstairs because my office was on the same floor as the minister's.

I am also very grateful to you, Mr. Chairman, for having chosen Charles Coombs to be the commentator for my lecture. No choice could have been more welcome to me. Charles Coombs is a good and an old friend. When he was Senior Vice President of the Federal Reserve Bank of New York, where he did, in my opinion, a tremendously good job, I had with him the most pleasant and, I think, fruitful cooperation for which I am very grateful. There is only a small problem about the designation of Charles Coombs as the commentator. The problem is this: A few years ago, as the Rector rightly recalled, Charles Coombs wrote a very good book on international monetary matters and he was kind enough to send it to me. I told him that I thought I could agree with him nearly 100 per cent on all that he had written. A few years later, I also happened to write a book on more or less the same subject. I sent the book to him and he told me that he had never realized how close we were to one another in our thinking. So, when I heard about his designation, I was a bit afraid that there would not be enough substance for a nice dispute and a lively debate. In order to try to avoid that, I have deliberately introduced in my address a few ideas with which he might disagree. Whether I have succeeded in this or not, we shall see.

Reflections on the International Monetary System

Guillaume Guindey

It is frequently stated nowadays that the international monetary system needs review and reshaping. It is sometimes added that the system no longer even merits the name. In my opinion, these criticisms are excessive. To some extent, perhaps, we may be dealing with a state of affairs instead of with a system in the true sense of the word, but this is not important. Whether it is a system or a state of affairs (I would rather go on calling it a system), allowing for the conditions currently prevailing in the world, the present organization seems fairly appropriate to me. To be sure, it is imperfect and could be improved: I will shortly say a few words about certain improvements that might be contemplated. Yet the present system does have some merits, and I would like to begin this lecture with an effort to highlight them.

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One often hears the complaint that the International Monetary Fund, the backbone of the system, no longer has enough authority over member countries. It is true that the member countries, as a rule, no longer need the agreement of the Fund to make changes in the par values of their currencies. It is also true that the overflowing international liquidity enables them, up to a certain point, to obtain external credits without having to appeal to the Fund. But the Fund has other means of action at its disposal. Thanks to its permanent relations with all member countries and to the authority of its staff, it is able to exercise an influence which is often all the more real for being unobtrusive. Above all, we tend to overlook the things that member countries might be tempted to do (and some of which they probably would do) if the Fund did not exist. Allow me to tell you a story I like very much, a tale about showers. In the small French village in Normandy where I was born, there were no showers for the children in the primary school (this was at the beginning of the century) and the children were very dirty. A generous benefactor had showers built in the school and a local woman was put in charge of washing the children. To everyone's surprise, it turned out that the children were very clean even before going under the shower. Knowing that their children were going to be examined by another woman of the village, their mothers had decided to bathe them at home. Now to my mind, in like manner the financial hygiene of a great many countries is a good deal better today than it would be if the Fund did not exist. Moreover, I note that the Fund—as well as the World Bank—will most probably be called upon to increase their lending activities in coming years: this will result in a strengthening of the influence of the Bretton Woods institutions.

We also hear that there is currently an increase in the number of forums for monetary cooperation other than the Fund and that this results both in a dismemberment of the Fund and a weakening of the system. I believe this point of view to be oversimplified and inaccurate.

It is obviously quite far from the mark as regards the Bank for International Settlements (BIS), which is now celebrating its fiftieth anniversary and where we are meeting today for the occasion. The existence of a special organization for cooperation between central banks is in the natural order of things. And it is difficult to imagine better relations than those existing between the Fund and the BIS. When the Fund was looking for a new Managing Director in 1956, the Executive Board appointed Per Jacobsson, Economic Adviser of the BIS. In 1963, when the BIS was looking for a new General Manager, it selected Gabriel Ferras, then the Director of one of the most important departments of the Fund. I would like, in passing, to take this opportunity to pay homage to the memory of these men, to whom the Fund and the BIS owe so much, both of whom were dear friends of mine. I would also like to stress that one characteristic of the methods of the BIS is its tradition of flexibility and pragmatism, traits which, in my opinion, are clearly among the strong points of the present international monetary system.

It is indeed true that money is now the topic of discussion within a number of forums that bring together only a limited number of countries. There are discussions within the Organization for Economic Cooperation and Development (OECD). There is the European Monetary System. There are occasional talks among a small number of major countries. There is also a kind of unwritten agreement among the central banks belonging to the group of Basle on the coordination of their interventions on the foreign exchange market, in particular among the Federal Reserve System, the Bundesbank, the Swiss National Bank, and the Bank of Japan. But all these arrangements seem likely to facilitate the solution of concrete problems originating in the particular situations of some countries and in the specific relations existing among them. It is in the interest of the entire international community that these awkward problems be solved in the best possible way. The Fund is always in a position to ensure that nothing done within these institutions runs counter to its fundamental objectives. In my view, this all reflects a realism for which we should all be thankful.

It is sometimes said that our system entails a number of unsatisfactory situations, an unfortunate lack of symmetry. Why is it that Switzerland is not a member of the Fund when it plays such an important role in the international monetary field? Why isn't Great Britain, a member of the European Monetary System, under the same obligations as the other member countries concerning its exchange rate?

To this I would say that in these cases we are dealing with *de facto* situations, that there is nothing tragic about them and that we should make the best of it. That's how the system works. The Swiss and British authorities certainly have good reasons for taking the attitudes they do. Furthermore, ways have been found to get around the resulting difficulties. The system gives Switzerland other opportunities to cooperate, and in a most effective way: OECD, BIS, Group of Ten, central bank agreements. Britain accepts the other obligations stemming from its participation in the European Monetary System and the Bank of England manages to work in great harmony with the central banks of the other countries in the System.

Then, too, it is sometimes said that the current system is a questionable hybrid because most countries, including the United States, have adopted a system of floating exchange rates, whereas an important group, that is the countries within the European Common Market, have chosen a mechanism of fixed exchange rates, at least among themselves. Here again, it seems to me that reality is much more satisfactory than appearances. Fortunately, the ideas and policies concerning floating exchange rates have evolved a great deal in the last few years; in particular, our American friends have become convinced that it is clearly in their own interest to keep a closer eye on the behavior of their currency on the foreign exchange market and to avoid erratic fluctuations likely to increase the risks of inflation in the United States. Meanwhile, the members of the European Monetary System have shown their ability to make adjustments in the parities of their currencies by mutual agreement when it proves necessary. The development of our system is thus tending to reduce the *de facto* difference between managed floating rates and fixed but adjustable parities. My friend Dr. Emminger would here be in a position to remind us of his famous question: "Is the zebra a black animal with white stripes or a white animal with black stripes?".

I would like to conclude this defense of our system by mentioning the clever way in which it has been handling the problems of gold. No question is more ticklish than this one. Indeed, nothing is harder to resolve than a theological controversy. And as far as gold is concerned, we are dealing with genuine theological warfare between those who think it is essential to eliminate any intervention of gold and any reference to it in international monetary arrangements, and those like myself—I freely admit it—who think gold is bound to play an important role because of certain irreplaceable qualities. This feud has resulted in a virtually insoluble problem, but to some extent our system has been able to solve it, and do so in a most elegant way: there was a decision to refer to gold in future as if it were no different from mere grains of coffee or lumps of sugar. At the same time, the countries which formerly banned purchases of gold by their citizens, as it was a metal reserved for the uses of central banks, no longer had any reason to prohibit such transactions. U.S. citizens in particular acquired the right to purchase gold freely, and did not hesitate to do so. Consequently, holders of dollars gained the option already held by holders of Swiss or French francs of exchanging their assets against gold. It is fair to say that the major currencies, the dollar in particular, are now convertible into gold. While they are not, of course, convertible at a fixed rate, they are convertible on the basis of a floating rate. Adversaries and supporters of gold differ in that the former regard this floating rate as meaningless, while the latter think it has some importance. Are the supporters numerous? Judging from the space newspapers devote to fluctuations in the price of gold, they must be.

The development of our system made possible one other improvement concerning gold. With the deletion of any reference to an official gold price from the Articles of Agreement of the International Monetary Fund, central banks were free again to choose any method of accounting for their gold reserves. Many of the major central banks had retained or accumulated considerable hoards of metal, and some of them have now calculated the value of these stocks on bases referring to market prices. This has resulted in substantial increases in the balance sheets of these banks and in their reserves. The U.S. Government did not follow suit. But many people in the world took pains to compute the current dollar value of the gold assets of the United States.

Some people will say that these consequences were neither sought nor foreseen by those who canvassed for the amendments to the Fund's Articles of Agreement, which in fact are at the origin of these results. I would say that Adam Smith's invisible hand works in wondrous ways and that mischievous souls may take this as proof that this hand really does exist.

Flexible, realistic, and pragmatic, by its very nature our monetary system has yet another quality: it is continuously evolving and can therefore rather easily adapt itself if circumstances so require. As many of its aspects result from the way it is applied and from the rules followed by monetary authorities rather than from treaties ratified by legislative bodies, it is not very difficult to adjust the system (or some of its parts at least) provided the monetary authorities are willing.

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Some will ask how it is that the current international financial situation is so unsatisfactory, disturbing, and worrying, while the system has so many good qualities and such a high degree of cooperation prevails among the authorities of the major countries? Even if the system is not fundamentally responsible either for domestic inflation or for the demands of the oil exporting countries, it must take some share of the responsibility. There should be a way to make it more appropriate than it is, more effective, in particular in the fight against world inflation. Are there many improvements which might be recommended today from this point of view, and if so, what are they?

I shall confine myself to a few remarks in this respect and avoid, for various reasons, touching upon certain major issues. Inflation, one of today's major problems, was treated by Arthur Burns in his lecture before the Per Jacobsson Foundation in Belgrade last year. He expressed himself so forcefully on the subject that I would be unable to add much to what he said. As for Eurocurrencies, especially the extent to which the market for them contributes to world inflation and the kind of supervision to which there may possibly be reason to subject it, the topic is far too complex for me to add anything to the work done over the years by the most qualified experts, to say nothing of taking sides. As for the various suggestions advanced here and there which call for amendment of the Fund's Articles and subsequent ratification by national legislatures, they involve legal and political ramifications which are beyond the field of my competence.

Somewhat less ambitiously, I would like to address myself to some preconceived ideas or dogmas which I think sometimes have a negative influence on the way our system works.

Upon reading the speeches of a number of policymakers in various countries, I detect the persistence of a more or less openly voiced opinion, namely, that since the instability of parities originates in the differentials between the various domestic inflation rates, those countries with high inflation rates should reduce them and those with low rates should allow them to increase, and we will all be better off for it. As our colleagues from the Bundesbank have been saying for a long time, this is a disastrous idea. First of all it is unrealistic, because countries sliding down the slope of inflation are generally not in a good position to control their speed. It is also dangerous, as the few havens of moderate inflation still remaining in the world are the main life preservers which other countries can try to grab onto in order to check their own slide. Surplus countries certainly have obligations toward deficit countries, such as granting them loans or advances, perhaps, but they are never under any obligation to make their own position worse. Yet this mistaken notion continues to obsess some people. To eradicate it would be a great step forward.

And this brings me to a second remark.

A dozen years ago or so, in 1966 or 1967, I had the privilege of being a member of a working group set up by the OECD to review the possible ways of using fiscal policy more actively as an instrument of economic policy. This group, chaired successively by Dr. Zijlstra and Mr. Walter Heller, issued a report containing a certain number of suggestions. The group had originally been set up after it had been noticed that some countries had used monetary policy for economic policy purposes under conditions such that serious problems for their partners had resulted. For this reason, it was felt that it would be proper for countries faced with economic problems to resort more extensively to instruments other than monetary policy—first and foremost fiscal policy—and to have recourse to monetary policy with more caution, showing increased consideration for the impact of such a move on foreign economies.

When I consider what has happened on the international monetary scene in the last few months, I have the impression that we have not learned very much from the lessons of the past. Truly enough, because of the political obstacles which always get in the way of an appropriately rigorous fiscal policy, the burden of fighting inflation to a large extent naturally falls to the central banks and money managers. It is wrong, however, to believe that sufficiently lasting results can be obtained in this way. The Heller Committee Report has had the usual fate of falling into oblivion, where it joins many of its kin. But would it not be a step forward if the ideas which inspired the work of the Committee were restored today?

Tribute should certainly be paid to the U.S. monetary authorities who, in late 1979 and early 1980, chose courageously and energetically to use every weapon at their disposal to restrict the availability of credit in their fight against inflation. It is to be hoped that their policy will finally be successful. However, the premium enjoyed by the dollar on account of interest rate increases in the United States, which has considerably strengthened its position on the exchange market, could only be a temporary phenomenon. It could not eliminate the basic vulnerability of the dollar. I would like to elaborate on precisely this question.

The vulnerability of the dollar is partly attributable to the rate of decline in its domestic purchasing power which threatens to cause a gradual easing of the value of the dollar against currencies such as the Swiss franc and the deutsche mark, both of which have a more resilient purchasing power. But to my mind the vulnerability of the dollar has been unnecessarily aggravated by some arguable ideas.

One such idea is an overpessimistic appraisal of the external accounts of the United States.

If we review the U.S. balance of payments since 1960 we see that it has been in deficit for all but two of those twenty years; the balance of payments on current account has only shown a deficit in nine out of twenty years, whereas the balance on capital account has been in deficit every year except two. We may also note that the combined total of current account deficits and surpluses during these two decades amounts to a net deficit of only about one sixth of the net overall balance of payments deficit during the same period. The remaining five sixths are accounted for by the cumulative capital account deficit. It should further be noted that published current account balances were somewhat undervalued until recently, this because foreign investment income reinvested outside the United States was not included in the receipts of the current balance.

Such calculations are somewhat approximate but are nevertheless interesting in that they demonstrate that the foreign position of the United States is stronger than is frequently maintained in international circles.

The share of the well-known dollar balances resulting from the current account deficits accumulated by the United States in the past, and which thus corresponds to a net loss of substance, does not amount to much. If this deficit is compared to the liquid assets now held by the United States in the form of gold reserves, it can almost be said that such liabilities are negligible.

The great bulk of dollar balances comes from capital account deficits, i.e., the excess of capital outflows from the United States over capital inflows into it. Such dollar balances have their counterpart in American foreign investments or loans to foreign countries. There must have been some losses on such investments or loans, but there have to have been capital gains on investments as well, specifically exchange gains.

The United States thus finds itself in the situation of a powerful and rich business concern, whose overall balance sheet shows large net assets and an unquestionably solvent position, but which has financed investments with short-term borrowing. Such a situation inevitably entails cash problems. The ensuing difficulties are serious but hardly tragic. Their nature is such that they should be rather easy to solve through proper cooperation between the principal creditors and the debtor country itself. I repeat, between the creditors *and* the debtor country.

Such a large overhang of dollars in the hands of foreigners is inevitably sensitive to fortuitous events of a political or economic nature, which promptly trigger speculative moves. The vulnerability of the main world currency is a factor of instability for the entire world. Meanwhile, while it is desirable for dollar fluctuations to be brought under control, it would not be sound under a floating exchange rate system to oppose movements explained by fluctuations in the parity of the respective purchasing powers. Such is the touchy problem that monetary authorities have to solve.

Much has been accomplished in this respect, mostly since the time when, on two occasions in autumn 1978 and 1979, the U.S. Administration showed that it indeed did care about the dollar rate and was interested in seeing it defended through cooperation among central banks.

But there is still a misunderstanding about the precise content of such cooperation. The feeling persists that, in a critical situation, the Federal Reserve System would be ready to do only one part of the job and expects certain foreign central banks to take up their share by purchasing dollars. As foreign central banks expose themselves to exchange risks when they buy dollars to support the U.S. currency, markets cannot help but wonder whether the total of funds available to support the dollar will be sufficient.

In fact, when the currency of one country is tending to depreciate against all the other major currencies, it is up to that country's monetary authorities—and them alone—to intervene on the exchange market as necessary, either directly or through other institutions acting on their behalf. Financial assistance from other central banks is often required, but the normal procedure should be limited to each central bank lending its own currency to the central bank of the country whose currency is in jeopardy. Such foreign currency loans have the great advantage of not forcing lending central banks to run exchange risks.

If such a principle were clearly to be adopted as the basis for cooperation between the monetary authorities of the United States and other countries, everyone would know that the United States is virtually assured from the outset of obtaining all the support it needs from other central banks, as such support would never entail exchange risks. The dollar would remain a floating currency, but its vulnerability to possible speculative attacks would be lessened.

But here we come up against another prejudice, and a very important one.

Some may respond to my suggestion by saying that it is unrealistic, since borrowing in currencies other than the dollar is contrary to the financial doctrine of the United States. If I recall the example of the Roosa bonds, that of the swaps concluded with certain central banks, as well as the issue of Carter bonds in Germany and Switzerland, I will be told that these are quite exceptional transactions involving very small amounts of money in comparison to the overall dollar holdings of foreign central banks.

My personal experience has taught me never to despair of the final triumph of common sense in the United States. In my opinion, those who deny the concept of foreign debts denominated in any currency other than the dollar, except for some exceptional instances, are taking a stance against common sense. I would like to illustrate my point with this example.

If the Swiss National Bank acknowledges a debt toward the Bundesbank, this debt will necessarily be denominated either in deutsche mark or in Swiss francs (setting aside, for simplicity's sake, the possibility of a debt in another currency). If the debt is denominated in deutsche mark, the Swiss National Bank is running an exchange risk; if it is denominated in Swiss francs, the Bundesbank runs the risk. One or the other must necessarily run a risk, so the question is which one should? There are three possible solutions. The risk may be run by the debtor alone, or by both debtor and creditor (for instance by denominating the debt half in deutsche mark, half in Swiss francs), or by the creditor alone. It seems that there are arguments in favor of each of the first two solutions. To my mind, having the creditor run the risk alone is indefensible, inasmuch as it amounts to making the value of his claim wholly dependent on a unilateral decision taken by the debtor.

This reasoning is perhaps oversimplified but it seems to me nonetheless true. If brought to its logical conclusion about half the debts of the United States with foreign central banks should be of the Roosa bond or swap type. We are obviously very far from that point at present, and I would not recommend going to such lengths.

I believe that if the U.S. authorities were to take a more liberal stance toward the concept of debts denominated in currencies other than the dollar, the following benefits could accrue:

—Those countries which, out of concern about the evolution of the dollar rate, wish to diversify their reserves by purchasing other currencies, are putting countries such as Germany and Switzerland in a difficult position as these two countries are obliged to hand over deutsche mark and Swiss francs when they buy dollars. If Germany and Switzerland could, within reasonable limits, exchange the dollars thus bought for claims against the United States denominated in deutsche mark or Swiss francs, these difficulties would be greatly alleviated.

—A further step might be contemplated. Consideration could be given to ad hoc agreements between central banks which would allow some of them which rightfully desire to diversify their reserves—primarily those having actively supported the dollar in the past—to buy Roosa bonds denominated in currencies other than the dollar, directly from the Federal Reserve System. This would lead to a decrease in the dollar overhang which is currently a burden on the market.

It may be retorted that such an idea might prompt a rush by central banks anxious to exchange their dollars against Roosa type bonds. I do not in the least believe that this would happen. On the one hand, these bonds would yield a much lower interest rate than dollar assets. On the other hand, central banks know that, apart from the consequences of the decline in the domestic purchasing power of the dollar, the external position of the U.S. currency is in fact very strong.

There may also be an objection to the effect that for the Federal Reserve System to be indebted to foreign central banks in currencies other than the dollar would constitute a dangerous precedent and that many other dollar claim holders in the world could invoke this precedent to ask for the conversion of their claims into other currencies. To this I reply that when the dollar was convertible into gold, only foreign central bank assets were convertible, and that no argument was ever made calling for the convertibility into gold of all dollars owned by foreigners. Furthermore, the convertibility into gold of dollars owned by foreign central banks was enough to ensure the par value of the dollar against gold. I also think that giving foreign central banks the option of buying Roosa bonds, even on a limited scale and on the basis of a floating dollar rate, would help increase the confidence of all dollar holders in the world.

Finally, an apparently decisive objection will be raised against my point of view, namely that debts denominated in currencies other than the dollar by definition entail an exchange risk for the U.S. Treasury and hence for the American taxpayer, and that getting Congress to make appropriations to cover such losses would be out of the question. Such reasoning overlooks the fact that the increase in gold prices has provided the U.S. Treasury with a huge capital gain in dollars, large enough amply to offset the merely contingent exchange losses which might be incurred on account of some indebtedness to other central banks in currencies other than the dollar.

To sum up, it seems to me that, alongside the three reserve instruments (the dollar, certain other currencies, and the SDR), there is in fact a fourth one, i.e., claims on the Federal Reserve System (or perhaps on other central banks) denominated in currencies other than that of the debtor.

To conclude my remarks on dollar vulnerability, I wish to observe that in addition to the intrinsic vulnerability of the dollar unfortunately resulting from domestic inflation in the United States, there is an artificial vulnerability which it should be possible to remedy by rather simple means. In other words, I believe that the illness of the dollar is to some extent illusory.

* * *

As for the international monetary system as a whole, it is up to governments to think about the suitability of making additional changes in the Bretton Woods agreement. But pending their agreement on this matter and the requisite legislative approval, it is important to know that we live in a viable system which, though not perfect, has very positive aspects, and which could be improved from the standpoint of effectiveness, in particular, if a number of arguable views were to be corrected. I have taken the liberty of listing several preconceived ideas and prejudices which, in my opinion, it would be worthwhile to revise.

Perhaps because it has been my honor to have been General Manager of the Bank for International Settlements, and because as a result I spent some very rewarding years in Basle, I tend to think that we have yet to reach the limits of what may be achieved through empirical arrangements between central banks. Central banks have indeed done a lot in the past and are doing a lot today. It is also true that they can only do so much in the fight against domestic inflation: governments carry an essential responsibility here. However, nothing which might strengthen the means of action of central banks must be overlooked. Nothing must be disregarded which might improve the efficiency of their efforts to reduce the volatility of markets, strengthen confidence in all currencies, and improve the contribution of the international monetary system to the fight against world inflation.

MR. MARTIN: I think we can all agree that Guillaume Guindey has given us a very thoughtful paper and has made a lot of points that we will want to ponder.

Our commentator, Charles Coombs, has traveled to the BIS from the United States more than any American, and I think I can truthfully say that during my ten years at the Federal Reserve we relied on him more than on anyone else for our understanding of what was happening at the BIS and what the thinking was here. Although we didn't always agree with him, we invariably benefited greatly from his comments. Mr. Charles Coombs.

Commentary

Charles A. Coombs

Ladies and Gentlemen: I am honored to be here and particularly pleased to share the same platform with my old friend Guillaume Guindey.

I found his lecture full of practical wisdom and shrewd insight, graced by his usual diplomatic courtesy, and concluding with some interesting recommendations for stabilizing our somewhat shaky world financial system.

The general thrust of his recommendations is that the United States can and should do much more in the way of providing exchange guarantees through Federal Reserve swaps, Roosa bonds (and, I presume, Carter bonds as well) to finance market intervention in defense of the dollar. More specifically, he is encouraged by forceful Federal Reserve intervention in the exchange markets since late 1978, which has been mainly financed by drawing on credit facilities such as the swap lines, thereby automatically providing a partial or complete exchange guarantee to the creditor country. But he puts this question: Why should not such exchange guarantees be extended to cover as well dollar support purchases initiated directly by a foreign central bank in its own market?

These suggestions, I must confess, arouse in me a certain sense of nostalgia, since I spent most of the decade of the 1960s negotiating the buildup and operation of the Federal Reserve swap network, as well as placing a lot of Roosa bonds with European central banks. I recall starting in 1962 with a $50 million swap line with the Banque de France. Eighteen years later the Federal Reserve swap network has grown to more than $30 billion. In those early endeavors to build the foundations of the swap network, I enjoyed the sympathetic support of Mr. Guindey and am gratified that our thinking continues to move more or less in the same general direction.

Unfortunately, in this decade of the 1980s, we are living in quite a different world from that of the 1960s, reflecting in part the sorry consequences of the doctrine of benign neglect that emerged in the 1970s. Back in the 1960s when the bulk of the foreign exchange business was done in Europe, compared to New York and the Far East, most of the exchange guarantees provided by the Federal Reserve and the U.S. Treasury arose, in fact, out of dollar support operations conducted by European central banks in their own markets rather than through direct intervention by the Federal Reserve in the New York exchange market. European central banks bought dollars and, at their request, we covered them by drawing on the swap lines. In effect, this came very close to the operational procedure that Mr. Guindey now proposes.

But we then had an official parity of the dollar against the European currencies and the yen and so it made little difference whether the U.S. exchange rate guarantees arose out of Federal Reserve or foreign central bank intervention in support of the dollar on the exchange markets. Both were attuned to the same objective of keeping the dollar within a prescribed and relatively narrow band.

But now in the continuing absence of a parity for the dollar, both the problem of intervention to defend the dollar, and that of appropriate exchange rate guarantees arising out of such intervention, have become much more complicated. As long as the United States remains uncommitted to maintaining a formal parity, a *de facto* parity, or even a target rate, I suspect that there are certain practical obstacles to reverting to the exchange rate guarantee procedures of the 1960s. As long as the U.S. authorities permit a wide range of fluctuation in the dollar rate, I would guess that they will want to keep the major intervention decisions, and the consequent extension of exchange guarantees, more or less in their own hands, subject to hour-to-hour if not minute-to-minute review. This would hardly preclude, of course, ad hoc arrangements under which a foreign central bank might be asked by the Federal Reserve to buy dollars to support a certain rate level with the understanding that such dollar receipts would then be mopped up by the Federal Reserve through a drawing on the swap line and consequent provision of an exchange guarantee.

I regret this situation of continuing exchange rate instability and can only hope that a settling down of world affairs and better financial management will permit and encourage us to move back to reasonably steady exchange rates among the dollar, the deutsche mark, the Swiss franc, and the yen. Exchange guarantees on a much enlarged scale do require, it seems to me, prior official agreement on the exchange rates to be defended through such guarantees. For myself, I would settle for a target rate system between the dollar, the currencies participating in the European Monetary System, the yen, and the Swiss franc. When that happy day arrives, I think that some of Mr. Guindey's recommendations would then become both feasible and desirable.

On the other hand, I would question whether U.S. exchange rate guarantees on dollars taken in by foreign central banks could or should be elevated to the status of a formalized general principle. Least of all, no central bank should feel constrained from taking on additional uncovered dollars if it feels so inclined, perhaps from a sense of joint responsibility for the reserve currency role of the dollar. Hot money continues to shuttle around in response to political events all over the world; whether the United States should provide exchange guarantees on a switch of dollars from country A to country B should be a matter of friendly discussion rather than a discipline sternly enforced on the United States. Conversely, when the deutsche mark, the Swiss franc, or the yen come under selling pressure, as they all did in the first quarter of this year, I think that the Federal Reserve should consider building up reserve balances in these currencies, also on an uncovered basis.

In general, I would visualize a pragmatic, bilaterally negotiated procedure of extending exchange guarantees, selectively focused on the small handful of central banks which coordinate their exchange operations with those of the Federal Reserve. And judging from past experience, the more informal the arrangement, the more efficiently may it be adapted to new needs and changing circumstances, including the problem of reserve diversification.

There is still another qualification that I would put on Mr. Guindey's advocacy of more liberal use of exchange rate guarantees by the United States. It is not hard for me to understand European creditor central banks wanting an exchange rate guarantee on at least some of the dollars they take in through market intervention. But I think they want something more than that, which I also fully understand, and that is the same assurance the United States seeks when it is lending money—that the money will be reasonably well spent rather than permitting a further postponement of corrective action.

When the dollar comes under heavy speculative pressure, a foreign central bank must consider more than the availability of exchange rate guarantees in deciding how much of its own currency it dares to print in exchange for the influx of dollars. There is an obvious inflationary risk here for the creditor country which should never, in all conscience, be invited to join the inflationary parade of the debtors. On this point, I heartily share Mr. Guindey's view.

This brings us, I think, to the question of the conditionality of international credit facilities, whether provided under the swap network, foreign currency bonds, or the International Monetary Fund. Such conditionality, requiring the borrowing country to undertake appropriate reform action as a quid pro quo for credit received, was given scant attention during the 1960s, partly because of the prevailing obsession with creating new forms of unconditional international liquidity, such as the SDR. One of the few contributions of the 1970s, it seems to me, was the introduction of a much needed element of conditionality into these international credit facilities. In this connection, I should like to pay tribute to the vigorous and successful effort made by Mr. Edwin Yeo, former Undersecretary of the Treasury, to apply such conditionality when the dollar temporarily shifted to creditor status in the mid-1970s. Having taken such an initiative, the United States can hardly object to the same standards of discipline that it has required of others.

Finally, what about gold? Mr. Guindey has commented sensibly on the recent defusing of the theoretical debate over gold by the passage of time, events, and changing public attitudes. At the risk of arousing some of the sleeping theologians I might venture a few additional suggestions.

First of all, I see no possibility whatsoever of the United States resuming official convertibility of the dollar into gold at some new official fixed price. I say this for purely technical rather than theological reasons. Secondly, in contrast to some voices on my side of the Atlantic, I see no case whatsoever for getting rid of gold as a monetary reserve asset. And, if certain countries choose to revalue periodically their gold stocks, reflecting current market values, this seems to me to be entirely their own business.

There is, however, a basic technical difference between the United States selling gold reserve assets on the open market to defend the dollar and foreign countries conducting similar gold sale operations to defend their currencies. In both cases, gold sales yield a dollar counterpart. A foreign central bank selling gold has no problem here; dollars are what it needs to defend its currency in the exchange market. But from the U.S. point of view, selling gold for dollars is a relatively inefficient way of defending our currency. After all, the

United States does have a dollar printing press and there are obviously far more efficient ways of regulating the level of the dollar ocean than by bailing it out with a golden bucket. The main objective of any future gold sales by the United States, it seems to me, should be to acquire not dollars but the foreign currencies we may need for market intervention in some emergency.

Accordingly, I look forward to the day when certain foreign central banks become sufficiently confident of the future of gold as a monetary reserve that they might stand ready to supply their currency in exchange for U.S. gold at a rate not too far off prevailing gold market price levels. Such gold sales to foreign central banks at U.S. initiative would be the most effective way of mobilizing the enormous strength of the U.S. gold reserve position in support of an orderly functioning of the international monetary system.

Questions and Answers

Following the formal presentations, Mr. Guillaume Guindey and Mr. Charles Coombs answered questions from the audience.

QUESTION: *Would you comment on the value of the Substitution Account in easing pressure on the dollar as the key currency in international monetary relationships?*

MR. GUINDEY: What I know about the Substitution Account I know only from the press, especially the *Press Review* of the BIS, which I read every day with great care. I must confess that I have not succeeded in mastering what the Substitution Account is exactly.

I am perplexed about several points. From an early version of the Substitution Account, I had the impression that it meant putting dollars into a hat and taking out special drawing rights. I did not quite understand how that could be done other than by some technical sleight-of-hand, a subject with which I am not too familiar. As I studied the Substitution Account further, I thought I understood that to make this operation of pulling a rabbit out of the hat succeed, the increased value of the gold held by the International Monetary Fund would be brought into play. This confused me even further, because I had always thought, based on old prejudices, that that gold belonged to all the members of the International Monetary Fund in common, and I could not quite see why an attempt was being made to use its added value to consolidate U.S. debts, even disregarding the regular claims of the developing countries to the added value of the gold. And, finally, a last source of confusion—I could not understand why, in searching for a means of covering a possible exchange loss, no thought was given to all the gold held by the United States and the considerable added value it had accrued. For these reasons, I do not understand the Substitution Account. Perhaps Charles Coombs has something to add.

MR. COOMBS: I am in the same fix as my friend Mr. Guindey as far as the Substitution Account is concerned. I really don't know enough about it to make any detailed comment. I just have the feeling, mainly on the basis of past experience, that it is directed primarily to the problem of reserve diversification. I think that problem could best be handled, as I indicated, right here in this building through flexible negotiations among a small number of countries. I think that that might yield a far more efficient and effective result than a broader and more generalized scheme.

QUESTION: *Do you think there is any hope of the SDR becoming an international currency? If so, how soon?*

MR. COOMBS: I would say that it has not the chance of the proverbial snowball in hell. I think that the SDR may have certain importance as a limited reserve asset. It may have certain uses as a standard of value, but I would think that the functioning of the international monetary system will be primarily based in the future, as in the past twenty years, on the whole spectrum of credit facilities that have been tested and tried and have proven, I think, more effective—particularly, if they acquire a certain element of conditionality. I would think that private use of currencies in international trading in the exchange markets will continue to consist entirely of a few national currencies.

MR. MARTIN: I can't resist interjecting here that I am a little more optimistic than Charles. Would you like to comment, Frank?

MR. SOUTHARD: In a cruel world it is a great mistake to turn aside from any device that may help us even a little bit. The Substitution Account would not save the world but it might help toward that end. The SDR has some usefulness and I think it would be a mistake to turn our backs on its further evolution as a reserve asset.

MR. MARTIN: We have had a most interesting afternoon and we have covered a lot of ground in a short time. Our subject was "Reflections on the International Monetary System" and I think we have had some good reflections today.

We are extremely grateful to our speakers, Guillaume Guindey and Charles Coombs, for their thought-provoking addresses, and to the Bank for International Settlements for providing us with the facilities for the meeting. I thank you all for your interest in the activities of the Foundation and for participating in this meeting.

The meeting is now closed.

Biographies

Guillaume Guindey was born on June 19, 1909 in Evreux. He received his university education at the Ecole Normale Supérieure and at the Ecole Libre des Sciences Politiques in Paris.

Mr. Guindey joined the French Treasury in 1932 at the rank of Inspecteur des Finances. He was in charge of the Foreign Section, in Algiers in 1943–44, and in Paris in 1944–53. During 1953–58 Mr. Guindey was President of the Mines de Cuivre de Mauritanie (MICUMA). From 1958 to 1963 he served as General Manager of the Bank for International Settlements, and from 1965 to 1972 he was President of the Caisse Centrale de Coopération Economique, Paris.

Since 1972 he has been President of the Compagnie International des Wagons-Lits et du Tourisme, Brussels, and has held various other business positions. Among Mr. Guindey's books are *The International Monetary Tangle* (1977) and *Vingt et une questions sur le capitalisme* (1978).

* *

Charles A. Coombs was born on April 9, 1918 in Newton, Massachusetts. He studied at Harvard University, receiving his A.B. in 1940 and his Ph.D. in 1953.

In 1942 Mr. Coombs joined the Federal Reserve Bank of New York, remaining there until his retirement in 1975. While with the Federal Reserve Bank, he served as Senior Vice President in charge of the Foreign Department and Special Manager of the Federal Open Market Account.

Currently, Mr. Coombs is a director, Discount Corporation of New York, and is also on the board of directors of several other companies. He is the author of *The Arena of International Finance* (1976) and of articles in various professional journals.

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