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Statement of

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Chairman, Board of Governors of the Federal Reserve System

before the

Committee on Banking and Currency

House of Representatives

On H.R. 10162

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It is a pleasure to be here today at the invitation of Chairman Spence, to discuss why the Federal Reserve supports H. R. 10162, and how the proposed special IMF borrowing arrangements contemplated under H. R. 10162 would fit in with other actions the Federal Reserve is taking to help preserve the strength of the dollar in the international payments system.

If we are to maintain vigorous, growing economies in the free world, we must have a system of international payments that permits countries to finance the goods and services they exchange with a minimum of risk and cost, whether payment is made in cash or on credit. We have come a long way since World War II toward the achievement of this goal. Western Europe has made a remarkable recovery. It has restored convertibility of its principal currencies, eliminated most of its trade controls, and reduced its tariff barriers.

These favorable developments have, however, brought with them new problems, as well as new opportunities. As it became easier to exchange one currency for another, flows of short-term funds between countries have increased. Holders of liquid funds have become increasingly aware of opportunities to benefit from interest-rate differentials and exchange-rate arbitrage.

International flows of funds in response to profit opportunities are useful features of a free world economy, and an increase in such flows should not, as a general matter, give rise to any concern. In

recent years, however, the continuing deficits in this country's international payments and the persisting surpluses of some European countries have created recurrent uneasiness in foreign-exchange markets and have added an element of destabilizing speculation to the profit considerations that ordinarily influence international flows of short-term funds.

H. R. 10162 would put the United States in a better position to deal with some of the problems arising out of this development. With this same object in view, the Federal Reserve has recently decided to re-enter the field of foreign-exchange transactions. The Federal Reserve, therefore, is particularly interested in the enactment of this legislation.

In order to bring both H. R. 10162 and the recent decision of the Federal Reserve into proper focus, we must remember that neither action will correct the underlying difficulty, which is our international payments deficit. Regardless of the methods chosen to deal with problems of international flows of short-term funds, the United States must achieve a balance between the amounts we spend, lend and invest abroad and the amounts foreigners spend, lend and invest here.

Until equilibrium is achieved in our payments accounts, there will be a risk that the flow of dollars into the hands of foreigners might become larger than they would be willing to hold. This state of affairs could lead to recurrent drains on our gold stock. And even if the dollars are not presented by foreign central banks to our Treasury for redemption in gold, the feeling of the financial community that the dollar balances of foreigners may be excessive could affect dollar rates adversely in foreign-exchange markets.

We must, therefore, work steadily to reduce and finally eliminate the deficit in our international payments. Among other things, we must seize every opportunity, major or minor, to build an even larger export surplus. And, as other countries grow and prosper, we should expect them to take a greater share of the necessary costs of mutual defense and aid to underdeveloped areas. Your Committee has recognized these needs in its consideration of recent legislation, such as the International Development Association Act and last year's authorization for an expanded export guarantee program.

Obviously, the present proposal to supplement the resources of the IMF will not reduce our payments deficit. But it will be of important help in maintaining orderly exchange markets during the period of adjustment and avoiding speculative forays against the dollar pending correction of our deficit. It will make possible an increase in international liquidity that would be available for meeting extraordinary movements of funds due to temporary factors.

The borrowing arrangements contemplated by H. R. 10162 will help to achieve this purpose in two ways. First, the knowledge of the existence of a mechanism that can mobilize, in addition to present IMF resources, about $4 billion in major foreign convertible currencies in support of the dollar will in itself restrain speculation against the dollar. Second, if any adverse developments should nevertheless occur, resulting in offers to sell more dollars than the normal dealings in the market would absorb, these facilities, together with our other resources

could be called upon to deal with any consequent disruption of exchange markets.

In case of established need, the IMF would sell to the United States for dollars the major foreign convertible currencies that the IMF would borrow from the other participating countries. The United States could then use these currencies to buy up dollars offered in the market by private holders, and to redeem dollars acquired by foreign central banks in excess of the amounts they are willing to hold. This would tend to prevent dollar holdings of foreign central banks from becoming a drain on our monetary gold stock.

The dollars acquired by the IMF in the course of these transactions would be kept by the IMF for three to five years, unless in the meantime our reserve position, as we might hope, had so improved that we would no longer need to continue the arrangement.

The contemplated Federal Reserve operations in convertible foreign currencies would complement the proposed IMF arrangements in two ways. The Federal Reserve would help to deal with minor pressures before they reach a scale commensurate with IMF action. And it could take prompt action in more serious circumstances while IMF arrangements are being worked out.

In accordance with established reserve banking practice, however, the System would not enter into long-term foreign exchange

commitments. That is to say, it would not make arrangements under which the United States would acquire foreign exchange for a period of three to five years, as under IMF procedures.

Federal Reserve foreign-exchange transactions and the proposed IMF arrangement would, therefore, complement each other. Both would play important roles in maintaining an efficient international payments system.

While reserve banks in other countries customarily engage in foreign-exchange operations, the Federal Reserve has not done so for its own account for many years. Until recently, the U. S. dollar has been the only fully convertible currency widely used in international transactions. Accordingly, the United States has been settling its international accounts exclusively by transfers of dollars and by sales and purchases of gold. The Federal Reserve Bank of New York has, however, continued to deal in foreign exchange for accounts of its foreign correspondents and as fiscal agents for United States government agencies. For the last year or so, it has also been operating for the account of the Treasury Stabilization Fund.

The Federal Reserve has recently acquired small amounts of several convertible currencies widely used in international transactions from the Treasury Stabilization Fund and has opened accounts with several European reserve banks. We plan to acquire further

amounts through open-market purchases of cable transfers or bills of exchange at home or abroad, when conditions on foreign-exchange markets are favorable, and also through reciprocal transactions with foreign reserve banks.

While in time it may be desirable to recommend amendment of the Federal Reserve Act to provide greater flexibility than we now have under the Act in carrying out these operations, it would be impractical to request such legislation before operating experience under existing authority has provided a clear guide as to the need for it.

The System will, of course, coordinate its foreign exchange operations with those of the Treasury Stabilization Fund. The relatively modest resources of the Stabilization Fund have been used recently to counteract speculative pressures in the exchange markets. The System operations will be conducted not only with broader resources than those of the Stabilization Fund, but also with an additional purpose.

Necessarily, operations of either the Fund or the System in foreign exchange will influence exchange rates in some degree. Indeed, one of the purposes of these operations will be to correct or avoid disorderly movements of exchange rates, which might otherwise spark disruptive flows of funds internationally.

But the System will also have this additional purpose: to improve the international payments system by cooperative arrangements with foreign reserve banks that would permit the financing of sudden large movements of volatile funds without impairing the role of the dollar as a medium for international transactions. In the case of an outflow from the United States, these arrangements would permit us to moderate its impact on our gold stock; in the case of an outflow from other countries to the United States, they would permit those countries to moderate its impact on their gold and dollar reserves. This would be one way in which the System would carry out its responsibilities for providing the U. S. economy with a sound dollar.

If we want cooperation from others, we must be prepared to cooperate with them. This principle is applicable also to the present proposal to strengthen the resources of the IMF. If we want foreign countries to lend additional support to the IMF, so that it will be better able to offset possible adverse pressures on the dollar, we must be prepared to lend dollars to the IMF, so that it will be better able to offset adverse pressures on other major convertible currencies.

In conclusion, we can look to these new arrangements in the international payments system to give us time to correct our balance-of-payments position. But we must clearly understand that they will not be substitutes for a basic cure.