double duty, so to say, it would at the same time reduce liquidity by robbing foreign exchange, including the dollar, of its quality as currency reserves.

Going for a moment beyond strict economics, it could probably be said that it would considerably weaken U.S. international leadership, in general.

Fortunately, there are other ways to reduce the required increase of interest rates. In general, it must be recognized that international capital flows do not depend just on interest rates, but on interest rates plus the state of confidence in the currency concerned.

If this confidence is high, a country may be able to sustain very low rates, thus Switzerland probably has about the lowest interest rates anywhere.

If, on the other hand, this confidence is shaken, even rather high interest rates may be insufficient to stabilize capital flows. In fact, some of the money the United States has been losing in recent months was going to a country with even lower rates, that is, Switzerland. Conversely, Germany found in 1960–61 that low rates did not stop the influx of foreign money.

The most effective alternative to undesirably high interest rates, thus, is restoring confidence in the dollar. I cannot go into all aspects of this problem here. In particular, I do not want to comment on the possibilities of further reducing military and other assistance or of making it conditional on purchases in the United States.

While in a state of confidence in the dollar, it may even be desirable for the United States to maintain a moderate deficit in her balance of payments in order to supply dollar reserves to the rest of the world, for the time being the deficit should be eliminated as far as possible. My following remarks will focus on two specific points.

EXCHANGE GUARANTEES BETWEEN CENTRAL BANKS

In past months central banks have been very active, bold and imaginative in devising new ways and means of assisting each other. Among these arrangements the recent dollar-franc swap between the Federal Reserve Bank of New York and the Swiss National Bank is of particular significance in this context.

On the surface it looks highly complicated and technical indeed. But the basic idea is quite simple and as far as I can see, it has not found the attention it deserves. It consists, in fact, in creating a new type of dollar, that is, dollars free from exchange risk. This means that 50 millions of "normal dollars" in the hands of the Swiss National Bank are replaced by the same amount of dollars carrying no exchange risk.

The Swiss commercial banks, in turn, have shown by their action that they are quite willing to take over these risk-free dollars at interest rates at which they could not be induced to hold the "normal dollars."

This operation killed two birds at one stroke: On the American side it prevented a further loss of gold because Switzerland is now willing to hold more dollars. On the other hand, liquidity in the Swiss market could be reduced because the Swiss banks are now holding U.S. Treasury bills instead of central bank deposits.