

because the misallocation is temporary in the former instance while it is permanent in the latter. Furthermore, in the case of an "offsetting-by-lending" government with a substantial previously accumulated holding of the liquid liabilities, it is easy to evade the spirit of the "offsetting by lending" agreement while strictly complying with its letter. What the central bank of the offsetting government can do is to substitute the newly issued, special securities of the borrowing country for older, previously held securities of the borrowing country. Thus, the new, special securities of the borrowing country simply take the place of regular securities that would have been held in the absence of the "offsetting by lending" agreement in the offsetting government's central bank portfolio.

In light of the foregoing analysis, the rationale of the German Government's policy with respect to its offset agreements is demonstrably sensible and shrewd. It was easy for the Germans to agree three times to "offsetting by buying" because, for 5 of the 6 years involved, the build up of the German military establishment was occurring while the domestic German economy was booming, and for the entire 6-year period, the comparative-cost conditions favored the United States as supplier of military equipment. Little, if any, misallocation of resources was implied in the German procurement in the United States in that such procurement would on economic grounds have occurred in the United States even in the absence of offset agreements. Yet such buying does not fit the "offsetting by buying" formula because this buying was not over and above the buying that would have occurred anyway. At the same time, the outward semblance of "offsetting by buying" was conveyed by the fact that, in contrast to the pre-1960 period, there was a sharp rise in German military purchases from the United States; but, of course, this contrast itself derives from the absence of a large-scale German defense buildup prior to 1960.

No sooner was it clear that the defense buildup would taper off and that the domestic German economy was softening, than the German Government began reflecting the German polity's reluctance to continue "offsetting by buying." In other words, no sooner would the "offsetting by buying" have become genuine—involving purchases from the United States that would not have occurred in the absence of an offset agreement—than the Germans insisted on the switch to "offsetting by lending."

German shrewdness in switching to "offsetting by lending" is further indicated by a closer look at what the new type of offset agreement implies. Since the German Government pledged itself not to convert dollars into gold, the Bundesbank's purchase of the special 4½ year notes merely takes the place of its holdings of U.S. currency or of other U.S. Government securities or both. Thus, the German "offsetting by lending" turns out to be merely the substitution of one form of dollar-claim holding for another form of dollar-claim holding in the Bundesbank's foreign-asset structure.

Specifically, as shown in table 1, the Bundesbank's freely usable external assets, in addition to gold, consist of U.S. dollars, DM bonds of the U.S. Treasury known as Roosa bonds, and other assets. Introduced in 1963, the Roosa bonds are intermediate-term, interest-bearing, nonmarketable but convertible U.S. Government securities denominated in Germany currency. Since 1965, the Bundesbank's holding of