# Central bank cooperation and US dollar liquidity: what can we learn from the past?[1]

## Per Jacobsson Lecture, 30 October 2020

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## Abstract

As the global policy community moves into what is certain to be a prolonged period of economic, monetary and financial challenges, it is useful to reflect on previous experiments with international cooperation and coordination. While the 1930s has long been the inspiration for monetary policy innovation, there are other useful periods. The 1960s was a high period for central bank cooperation and coordination at a time when dollar liquidity became a global shared interest. A range of innovative solutions - including central bank swaps - were designed to stabilise the monetary and financial system. The conflict between the common interest in sustaining offshore dollar liquidity and the shifting domestic monetary policy stance of the United States ultimately ended this experiment. This episode emphasises the asymmetry of swaps as a means of central bank coordination for managing dollar liquidity. The 1960s also highlights several factors that influence the effectiveness of central bank cooperation: tensions between discretion and public scrutiny; the role of the Bank for International Settlements versus the International Monetary Fund; and the overwhelming importance of American engagement. Finally, the wider governance of the BIS since 2010 should allow it to play a more meaningful role once again in central bank coordination as we face the challenges of the next decade.


[1] I’d like to thank Barry Eichengreen, Robert N McCauley and Ted Truman for comments on earlier drafts.

This, the BIS's 90th anniversary year, was originally meant to provide an opportunity to celebrate the survival and adaptation of this unique institution through the gyrations of decades of profound change in the global monetary and financial system. It was also an opportunity to reflect critically on some more controversial areas of the bank's history – for example, my contribution to the anniversary book describes the tortuous progress toward expanding the membership and governance of the BIS to better match the global system and the entrenched resistance to that process among past governors.[2] Instead, the 90th anniversary has fallen in what is arguably the world's greatest human challenge in 70 years, a catastrophic year that has challenged the precepts of international cooperation that lie at the heart of the BIS's mission, while at the same time confirming the importance of international coordination in the face of a simultaneous global shock. Last year, three months before the pandemic struck, Sir Mervyn King finished his Per Jacobsson lecture with Keynes's warning that "The difficulty lies, not in the new ideas, but in escaping from the old ones." Rather than an escape from old ideas, my lecture this year seeks inspiration from them. There is an old adage that, if you want to enjoy eating your sausages, you should never visit a sausage factory. Seeing how they are made exposes the mess and waste that is neatly encased in the final product. So it is with history – my work delves into the secret internal correspondence, the abandoned plans, the compromises and the manipulation of data that go into economic policymaking. Now, as the Governors and their staff present today are well acquainted with the sausage factory of central bank cooperation, I hope that they will not lose their appetite for it by hearing from the hidden records of their predecessors.

The BIS was founded in the crucible of the post-WWI reshaping of the European political and economic landscape in the midst of what turned out to be a Thirty Years' War, but it quickly grew out of the constraints of its original purpose of governing reparations. The first BIS AGM took place in May 1931, just after the start of the Credit-Anstalt Bank crisis in Austria threatened European (and therefore global) financial stability and tested the new institution's ability to foster effective central bank cooperation. At the height of the crisis in September 1931, Per Jacobsson made his transition from the League of Nations to become the BIS's Economic Adviser, a post he held for the first 25 years of the Bank's existence. In the end, of course, central bank cooperation was unable to prevent the European financial crisis that toppled the international economy. After the Second World War, there was considerable hostility to the persistence of this central bankers' club (particularly as a rival to the new International Monetary Fund), but the BIS successfully reinvented itself several times over in the decades that followed: hosting European monetary cooperation, taking charge of data collection and dissemination, managing global liquidity (as we shall see) as well as exchange rate dynamics in the 1960s and 1970s, and setting banking standards from the 1970s and 1980s. But it retained its essential features as a bank for central banks and as a forum for discreet exchanges of view and the development of personal relationships among central bankers to promote cooperation.

2 C R Schenk, "The governance of the BIS 1973–2020", in C Borio, S Claessens, P Clement, R McCauley and H S Shin (eds), *Promoting Global Monetary and Financial Stability: The Bank for International Settlements after Bretton Woods, 1973–2020*, Cambridge, 2020, pp 46–93.

To mark the BIS's 75th anniversary (in 2005) the Bank commissioned a group of essays specifically on the history of central bank cooperation, which was published in 2008, just at the time when the global financial crisis struck.[3] As Piet Clement pointed out then, central bank cooperation stems from the origins of modern central banking in the 19th century, particularly in the management of the classic gold standard. In the 1920s, Montagu Norman and Benjamin Strong envisaged a network of cooperating central banks around the world and set about establishing them in the emerging markets of their day in Latin America and Australasia.[4] It is not my intention to rehearse the well established trend of waxing and waning cooperation detailed in that volume and by many others.[5] Rather I hope to highlight some less well recognised episodes and reflect on how the past has been used in policymaking.

First, I want to make a distinction between cooperation and coordination. Cooperation, as it sounds, is operational, particularly the gathering and dissemination of information, sharing best practice, research and data, and creating operational structures to enhance the functioning of markets.[6] This is the very bread and butter of the BIS. Coordination goes deeper to require the common application of rules (such as FX intervention) or setting and applying codes of common standards, such as through the Basel Accords. In both cases, there needs to be a common interest but the relative costs and benefits can be lower with cooperation than with coordination, which entails sharing control or sovereignty.

To make this distinction clear, we can consider the Basel Committee itself. It was founded after a tremor in the newly internationalised banking system in the summer of 1974 revealed how the model of prudential supervision based on national central banks no longer matched the structure of international banking. The G10 Governors' original mandate for the committee was to establish an early warning system for a cross-border banking crisis. But this level of coordination was rejected by the committee at its first meeting by the Chair, George Blunden from the Bank of England.[7] In the end, the Committee could not produce an agreed response to the Governors' call for an early warning system and Blunden submitted his own response, which focused on sharing best practice and confidential knowledge (what they called gossip) rather than creating an early warning system for cross-border banking crises.

3 C Borio, G Toniolo and P Clement (eds), *The Past and Future of Central Bank Cooperation*, Cambridge University Press, 2008.

4 C R Schenk and T Straumann, "Central banks and the stability of the international monetary regime", in M Bordo, M Flandreau and J Qvigstad (eds), *Central banks at a crossroads: what can we learn from history?*, Cambridge, 2016, pp 319–55.

5 H James, "International cooperation and central banks", in Y Cassis, R Grossman and CR Schenk (eds), *Oxford Handbook of Banking and Financial History*, 2016; H James, *International monetary cooperation since Bretton Woods*, Oxford University Press, 1996; H James and M Feldstein (eds), *International Economic Cooperation*, University of Chicago Press, 1988; M Bordo and C R Schenk, "Monetary policy cooperation and coordination: an historical perspective on the importance of rules", in M Bordo and J Taylor (eds), *Rules for international monetary stability: past, present and future*, Hoover Institution, 2017; C R Schenk, "Coordination failures before and after Bretton Woods", in M Qureshi and A Ghosh (eds), *From Great Depression to Great Recession: the elusive quest for international policy cooperation*, IMF, 2017.

6 For a discussion, see H James (op cit) and R Cooper, "Almost a century of central bank cooperation", in Borio, Toniolo and Clement, op cit.

7 C R Schenk, "Summer in the City: banking failures of 1974 and the development of international banking supervision", *English Historical Review*, vol 129, no 540, October 2014, pp 1129–56.

The committee then spent months trying to set out jurisdictional responsibilities for banks' foreign branches and subsidiaries, but progress was limited and it was accepted that cooperation would continue to rely on confidentially sharing information between central banks rather than on new initiatives. The first years of the Basel Committee therefore enhanced cooperation but also demonstrated resistance to coordination. From its start, the main obstacle was an inability to resolve where the responsibility lay for the lender of last resort in a globalising banking and financial system where the currency of international finance was the dollar. This remains an important open question – answered in part by central bank swaps, to which I will return.

There is a huge literature on international economic and monetary cooperation, much of the best of it written by members of the panel present today.[8] That's not the kind of coordination that I am going to stress today. Instead I'm going to focus more on the antecedents to the coordination that central banks pursued in the late 2000s. But first a reflection on how history, or the past, has been used during the latest decade or so.

## Using the past – 1930s

At times of crisis, or when change is on the horizon, policymakers and the public often invoke past episodes and experiences to explain their responses. This year, for central bankers facing the urgency of the pandemic's potential impact on the international financial system, the experience of 2007–08 was particularly close to hand. The innovations and structures deployed in that crisis (eg central bank liquidity swaps) were quickly reactivated and extended. It seems that central bankers have already learned from history about the importance of coordination to ensure adequate dollar liquidity around the world.

This was a lesson drawn most directly from the 1930s and reflects the prominent role of economic historians in framing our understanding of how to respond to financial crisis, eg Christina Romer as head of Obama's Council of Economic Advisers, or Ben Bernanke, Chair of the Federal Reserve in 2008. The memoirs of many of the key actors make explicit how they were influenced by histories of the Great Depression.[9] When the global financial crisis struck, the 1930s became the benchmark against which the intensity of the economic crisis was measured.[10] The solution in the United States was linked directly to Friedman and Schwartz's seminal *Monetary History of the United States* (1963), which blamed the US depression on the

[8] I'd especially point out Harold James' work, cited above, and Linda Goldberg's, Brad Setser's, Adam Tooze's and Ricardo Reis's separate assessments of the effectiveness of recent central bank swaps. L Goldberg, C Kennedy and J Miu, "Central bank dollar swap lines and overseas dollar funding costs", Federal Reserve Bank of New York, *Staff Reports*, no 429, 2010; S Bahaj and R Reis, "Central bank swap lines", Bank of England, *Staff Working Papers*, no 741, July 2018; A Tooze, *Crashed: how a decade of financial crises changed the world*, Allen Lane, 2018.

[9] B Bernanke, *The courage to act: a memoir of a crisis and its aftermath*, W Norton, 2015; A Darling, *Back from the Brink: 1000 days at Number 11*, Atlantic Books, 2011, Chapter 8; T Geithner, B Bernanke and H Paulson *Firefighting; the financial crisis and its lessons*, Profile Books, 2019.

[10] K O'Rourke and B Eichengreen, "A tale of two depressions redux", VoxEU, March 2012.

failure of the Federal Reserve to pursue an expansionary monetary policy.[11] From 2008, central banks embarked on a dramatic monetary expansion, led by the US Federal Reserve. But this was not a cooperative or coordinated initiative on an international basis.[12]

Thinking back to the lessons of the past, many of the efforts at international coordination in the 1930s were less successful than those of the 2000s. In 1931, the BIS arranged a network of central bank credits to the Austrian and Hungarian central banks to try to forestall the collapse of the Credit-Anstalt and the Austrian currency, but this ambitious initiative eventually failed.[13] Notably, the Fed was a major contributor despite the government's isolationist stance. Unlike the G20 Summit in 2008, the World Economic Conference of 1933 failed to deliver anything meaningful. Three weeks into the 12-week schedule, President Roosevelt suddenly announced that the talks were too biased toward exchange rate policy and not enough toward promoting recovery. With the Americans unwilling to participate, the meeting ended early.

Forty years later, in 1973, just as the Bretton Woods system collapsed and the dollar floated, Charles Kindleberger published his classic *The World in Depression 1929–1939*. He argued that, when the American government turned away from international cooperation after 1919 and did not sustain open markets and countercyclical international lending, this worsened the global depression. Back then, the Americans learned this lesson relatively quickly and took a very different role in the reconstruction of the international economy after 1945, building their vision of post-war trade and payments into their negotiations with the United Kingdom over wartime support for the Allied cause. From the Atlantic Charter, signed dramatically by Churchill and Roosevelt in the North Atlantic off Newfoundland in 1941, through to Lend-Lease and then the White Plan for the International Monetary Fund, the wartime American administration was committed to freer trade and payments and formal institutions for coordination. They found general agreement from the United Kingdom and other European states on the principle if not on the detail. In sum, a "lesson" from history is the persistent importance of American leadership – this isn't just because of the size of its economy and geopolitical power but also because of the importance of dollar liquidity in global markets.[14]

## Beyond the Great Depression – weaving the global financial safety net in the 1960s

While the 1930s interwar depression remains a touchstone for central bankers looking for lessons, they should also look beyond this episode and an obvious place to start

[11] For a critical view, see B Eichengreen, *Hall of Mirrors: the great depression, the great recession and the uses and misuses of history*, Oxford University Press, 2015.

[12] The Bank of England launched its programme in March 2009, the ECB in May 2009, and Japan renewed its quantitative easing in October 2010. Other important central banks such as the People's Bank of China took other routes to ease borrowing conditions and promote growth.

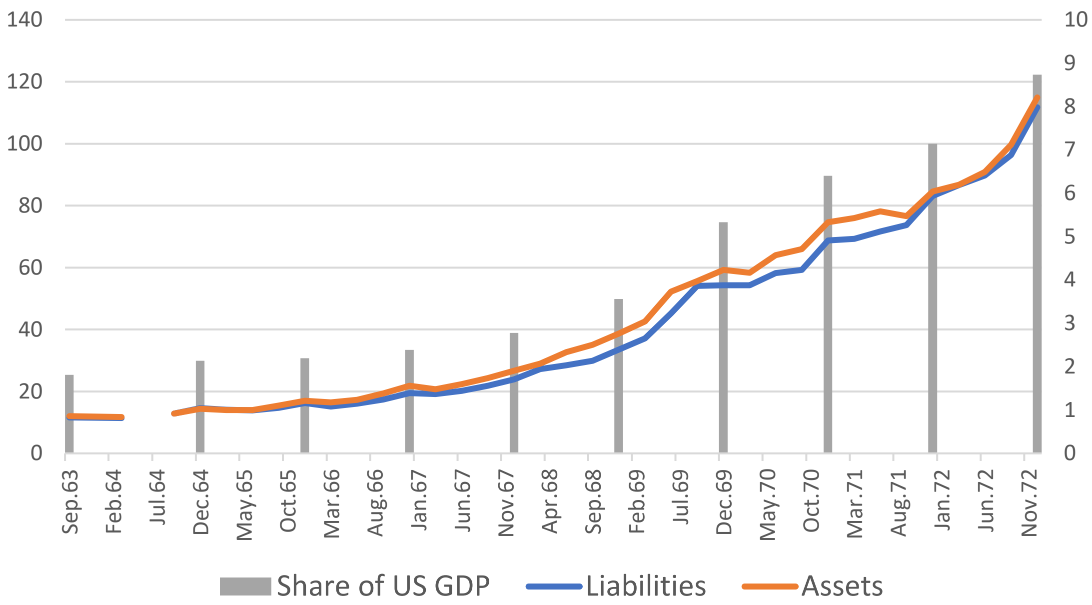
[13] G Toniolo, *Central Bank Cooperation at the Bank for International Settlements*, Cambridge University Press, 2005.

[14] This lesson of the 1930s has recently become even more clear in many international forums dealing with eg climate change (Paris Agreement), trade (WTO) and health (WHO).

is the Bretton Woods era when pegged exchange rates highlighted the interdependence of policymaking. During the 1960s central banks began to knit together an international financial safety net once it was clear that the IMF's limited resources, slow procedures and conditionality were no match for rising capital flows.[15] This was an era of global imbalances, blamed on inflation and low savings on the American side, and on German balance of payments surpluses on the other. It was an era when the mechanics of monetary policy were not always well understood, and well before the generalised shift to central bank independence in the 1980s and 1990s. Moreover, it was a period of pegged exchange rates rather than a floating dollar. But dollar liquidity was under intense discussion during the 1960s – was there too much liquidity (generating global inflation) or was there too little liquidity (so the system needed another international money)? The 1960s was the decade of the retreat of sterling as a source of global liquidity (the share of sterling in global FX reserves, for example, was overtaken by the dollar in 1955). I've argued that this process happened as smoothly as it did because of multilateral central bank cooperation.[16] But these were mainly arguments about reserves liquidity, not global financial liquidity. Exchange controls inhibited capital flows but this was nevertheless an era of surging offshore dollar liquidity through the Eurodollar market (Graph 1). This novel market prompted multiple innovations in international central bank cooperation.

Eurodollar market - commercial banks' dollar liabilities and assets with non-residents

($ billions) Graph 1




Source: BIS Annual Reports

15 Cooper op cit (2008) describes how the 1960s "saw the real birth of multilateral central bank cooperation envisioned but stillborn in 1930".

16 C R Schenk, *The Decline of Sterling: managing the retreat of an international currency 1945–1992*, Cambridge University Press, 2010.

Among the many plumbing patches to shore up the international monetary system, the G10 central bankers made a pact in 1961 to support the dollar market price of gold at the official Bretton Woods level.[17] These operations brought foreign exchange managers together regularly in Basel to discuss global liquidity and exchange markets. Their frank and private discussions in what became the Gold and Foreign Exchange Committee (now the Markets Committee) eventually inspired the Eurocurrency Standing Committee specifically to monitor and discuss the burgeoning Eurodollar market. There was another outcome of the Gold and Foreign Exchange Committee meetings that has not been well understood and that is the reporting of the Fed's central bank swaps and the multilateral system of central bank credits.

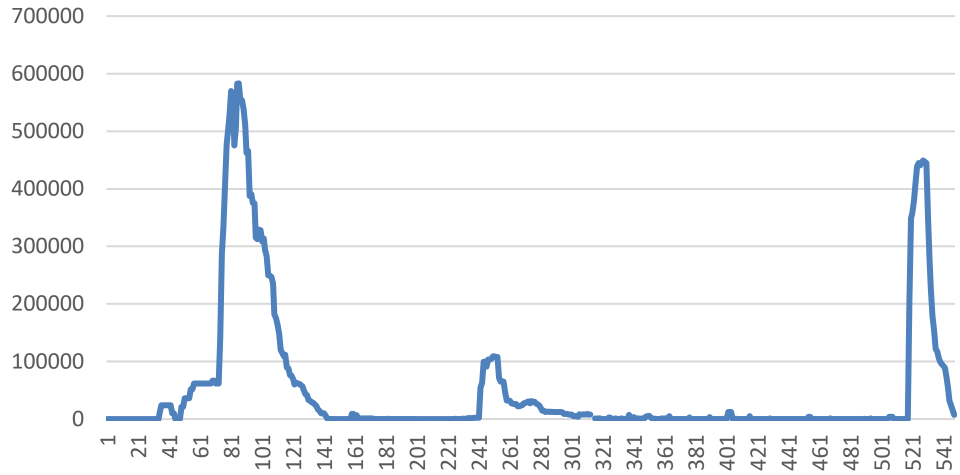
## Federal Reserve swaps then and now

I'd like to spend some time discussing the origins of Federal Reserve bilateral currency swaps, which became such an important part of central bank coordination in 2008 and again in 2020 (see Graph 2).

Federal Reserve central bank swaps 2007–20

USD millions

Graph 2




Source: FRED, Federal Reserve Economic Data, Federal Reserve Bank of St Louis.

There are three key points I want to make; first, that this system was pushed on a reluctant group of European central banks by the Federal Reserve. Second, that the idea arose and developed in the context of an emerging system of European multilateral central bank support and other US bilateral credits so the swaps should not be viewed in isolation. Finally, while the swaps were used to support the pegged exchange rate system, they were also used to support dollar liquidity in banks outside the United States – this is analogous to how they have been used since 2008.

From their origins in 1962 to the suspension of dollar gold convertibility in August 1971, the Fed's central bank swaps were designed to have a range of

[17] M Bordo, E Monnet and A Naef, "The gold pool (1961–1968) and the fall of the Bretton Woods System: lessons for central bank cooperation", *Journal of Economic History*, vol 79, no 4, December 2019, pp 1027–59.

purposes. Most of the histories of this period stress that they provided resources to intervene in the foreign exchange market. Indeed, this perception is so entrenched that, when Ben Bernanke proposed them in December 2007, one member of the FOMC (William Poole – Governor of the Reserve Bank of St Louis) objected that resurrecting swaps would be interpreted as a signal that the Fed was about to intervene to manage the dollar exchange rate.[18] Certainly, protecting the dollar's gold price was the motivation for the Fed's first swap with the Swiss National Bank, which was already in place by 1960. The desire by Swiss banks to reduce their dollar holdings at seasonal reporting dates and the preference of the Swiss National Bank to hold gold in its reserves led to a complicated trilateral short-term swap between the BIS, the Fed and the Swiss National Bank to juggle flows of Swiss francs, gold and dollars at seasonal turns. Rather than providing funds to operate in the FX market, this Fed swap managed seasonal window-dressing of commercial banks' growing dollar operations.

This was the model for the origins of the Fed's swap system. But the inspiration also drew on multilateral central bank support for sterling in the spring of 1961. Then (as 30 years earlier) European central banks deposited dollars or national currency at the Bank of England on three-month terms. The value of the deposits was guaranteed and they were renewable up to three times. When the Bank of England couldn't repay on final maturity, it had to go to the IMF for the funds. The deposits were made available to the Bank of England so that it could intervene to protect the value of sterling during what was expected to be a short-term period of pressure. This European central bank deposit system was organised at meetings at the BIS in March 1961. The next year, it was changed into what was known as the Bilateral Concerté – not formally multilateral, but a system of bilateral guaranteed deposits and lines of credit communicated through the BIS as an information-broker and as a willing participant – and this broadened it beyond Europe to include Canada, Japan and the United States.[19] In addition to the European network, there were also other bilateral Fed arrangements: dollar deposits against guaranteed sterling, swaps with the Treasury's Exchange Stabilisation Fund. These were all threads to the global financial safety net within Europe and across the Atlantic.

In the spring of 1962, Charlie Coombs, the head of the FX desk at the Federal Reserve Bank of New York, travelled around European capitals selling his idea for a wider system of bilateral Fed swaps. It is clear from the archive records of his conversations, first, that European central bankers couldn't see the point of standing swap facilities and, second, that they weren't keen on getting involved. They worried that the swaps would fund Fed intervention that would go against their own operations. Maurice Parsons, Deputy Governor of the Bank of England, advised that "as an exchange operation we could…only recommend that it be turned down" but that it had "symbolic" importance "comparable to deals done under the Basel arrangements".[20] Moreover, Coombs didn't have a clear idea what the swaps were for: they "might use them to support the dollar" but also "to provide a groundwork to cope with seasonal payments movements and with hot money swings". But he

[18] FOMC Minutes Transcript, 11 December 2007.

[19] "Continuation of the EMA Agreement until the end of 1963", Final Report of the Board of Management of the European Monetary Agreement, 21 January 1962, BIS Archives [hereafter BISA] GILB9 7.18(23).

[20] Letter Parsons to Rickett, 15 March 1962, Bank of England Archives [hereafter BoE] C43/742.

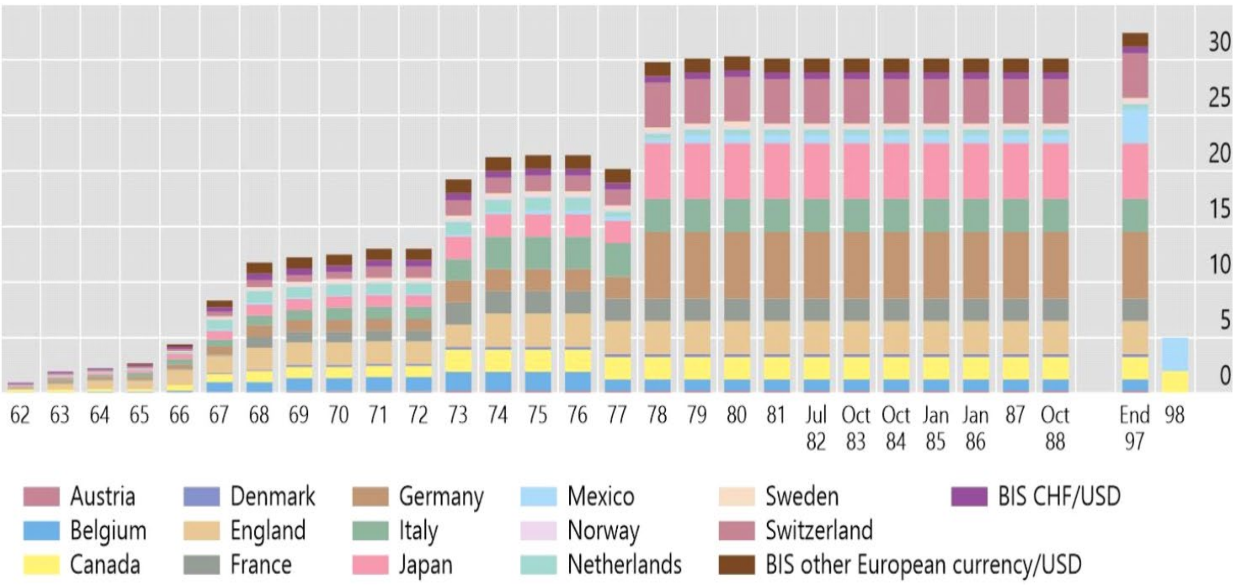
settled with the Bank of England on the following three "specific aims": "a) to counter speculative pressures, b) in some measure to offset seasonal swings, c) for such other purposes as might be mutually agreed, e.g. to cushion a sudden and fortuitous exchange loss the publication of which might be capable of adverse psychological effect or even of setting off a speculative movement".[21] Importantly, from the Fed's point of view they provided FX separately from the Treasury-controlled Exchange Stabilisation Fund so they also paved a way for the Fed to get involved in the Bilateral Concerté – to play its part in the global financial safety net that European central bankers were weaving.[22]

Graph 3 shows the value of Fed swap facilities and how they expanded quickly in the mid-1960s, again in 1973 when the dollar floated, and then in 1978 when there was another bout of dollar weakness. It was a pretty diverse group with small states such as Denmark and Norway and also Mexico; the FOMC tried but failed to come up with an ex post set of criteria in 1967. In 1970, when Ireland tried to join, it was refused because the Fed did not want to open the door to more small states.[23] Limiting the range of swap partners has a long history.

Federal Reserve swap lines, 1962–98

In billions of US dollars at end-year

Graph 3




Source: Federal Reserve

This was a time of inflation, so Graph 4 presents the value of the facilities relative to global reserves at the time, and shown in dollars representing the same share of US GDP in 2017. In the late 1960s, these facilities were equivalent to about 30% of global foreign exchange reserves or over 40% of the FX reserves of advanced economies. At their peak they were equivalent to the original swaps offered in

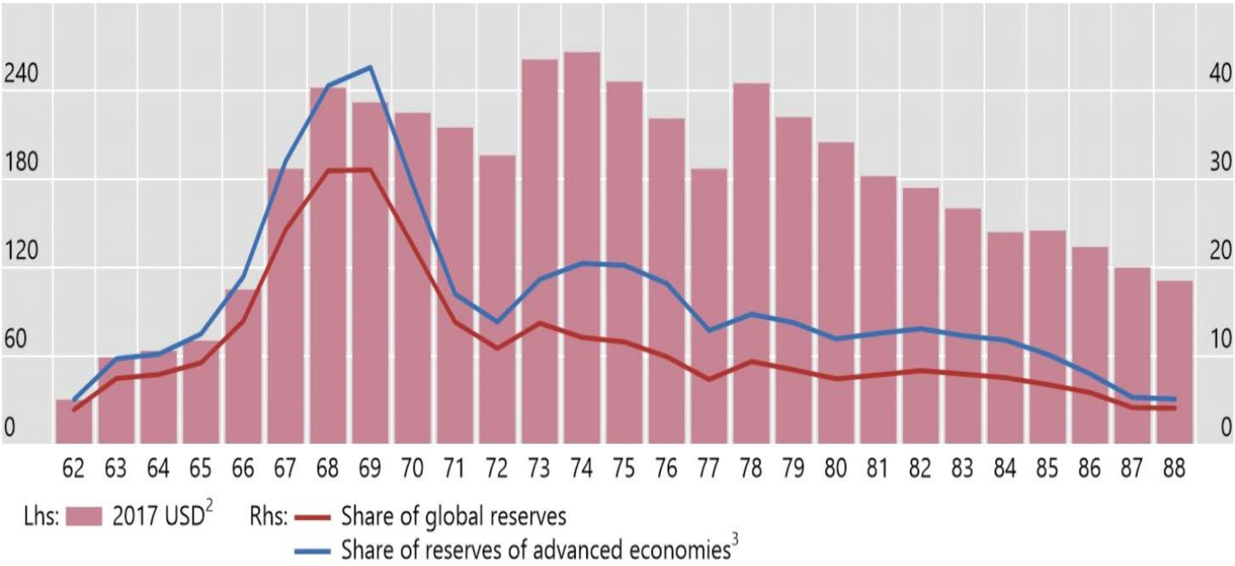
21 Note of Basel meeting 10–12 March 1962, memo dated 13 March 1962, BoE C43/742.

22 The swaps become so important that, from October 1964, Japan and Canada joined the BIS Gold and Foreign Exchange meetings explicitly because they had Fed swaps and this is where they were discussed. Note of meeting of Gold and Foreign Exchange Committee, 4 July 1964, BISA HAL2 F01.

23 FOMC memorandum of discussion, 10 February 1970.

September 2008 (before the limits were lifted). They were thus an important part of the global financial safety net and were used frequently by the Fed and its partners, as shown in Graphs 5 and 6.

Fed's reciprocal swap lines in relation to US GDP and global reserves[1] Graph 4

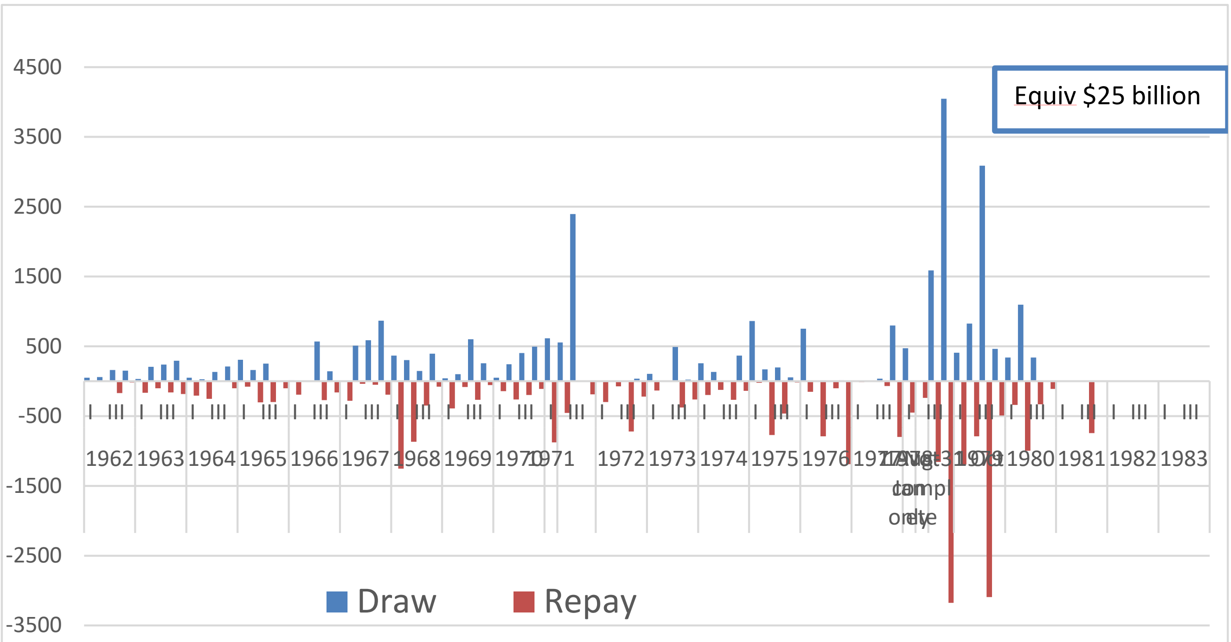



[1] Swaps data are from end of year except: 1983, 1984 and 1988 October, 1985 and 1986 January, 1982 July. [2] Scaled to 2017 US GDP in billions of US dollars. [3] Reserves exclude gold and SDR.

Sources: Federal Reserve; IMF, *International Financial Statistics* (December 2019); Bureau of Economic Analysis; UK Data Service; authors' calculations.

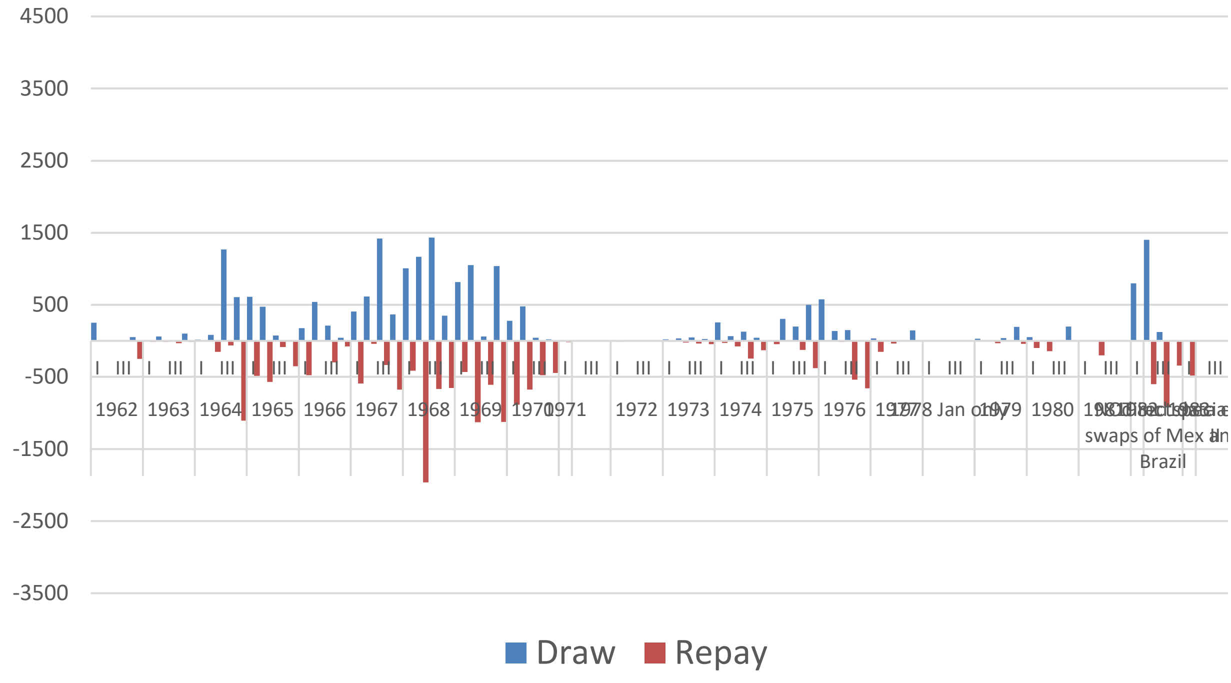
Fed's gross total drawings and repayments of central bank swaps

(US$ millions) Graph 5



Partner drawings on Fed swaps 1962–83 (Q2)

(US$ millions equivalent) Graph 6




As I've said, the Fed swaps were also embedded in a broader set of bilateral arrangements, as shown below. The Fed used the swap lines as its contribution to short-term credit facilities: Bilateral Concerté and the Group Arrangements to support sterling's decline that followed in 1968 to 1977. [24] These arrangements were often backstopped by the IMF – so that the United Kingdom, for example, periodically drew on the IMF to repay European facilities and Fed swaps when they could not be reversed in six or 12 months, most famously (and finally) in 1976.

[24] The Fed also coordinated separate swaps using ESF resources.

FRBNY swaps embedded in network of swaps 1964–70)

(Amounts in millions of US dollars) Table 1

| | Date | Bilateral Concerté | FRBNY swap | BIS | Total |
|---|---|---|---|---|---|
| Bank of England | November 1964 | 1280 | 1000 | 250 | 2530 |
| Bank of England | September 1965 | 475 | 400 (GBP deposits) +750 swap | 50 | 925 |
| Bank of England | September 1966 | 350 | 1350 | | 1700 |
| Bank of England | November 1967 | 850 | 1500 swap + 500 | 150 | 3000 |
| Bank of England | March 1968 | 1075 | 2000 swap +550 | 250 | 3875 |
| Bank of England | March 1969 | 800 | +350 | 250 | 1400 |
| Bank of England | June 1976 | 2600 | 2000 | 150 | 5300 |
| Bank of England | February 1977 | | | | 3000 |
| Bank of France | July 1968 | 600 | 600 | 10 | 1300 |
| Bank of France | January 1969 | 1350 | 500 | 100 | 1950 |
| Bank of France | August 1969 | 1700 | 500 | 300 | 2500 |
| Bank of France | February 1970 | 303 | 500 | | 803 |
| Bank of Italy | March 1964 | 350 | 250 | | 600 |

Bilateral Concerté are predominantly facilities for dollar deposits on three-month maturity, renewable once. Some are for currency swaps in other currencies (eg Bank of France, 6 January 1969 DM/FF swap offered by Bundesbank for equivalent value of $600 million).

Sources: BISA 7.18(23) GILB9; Schenk (2010) op cit.

As I've said, the 1960s Fed swaps had a range of purposes: window-dressing reserves, contributing to the multilateral safety net, providing funds for FX intervention by the Fed and the Fed's partners, and making the dollar more attractive as a reserve asset for central banks, like that of Switzerland, which preferred gold. But it is a further purpose that I want to turn to now.

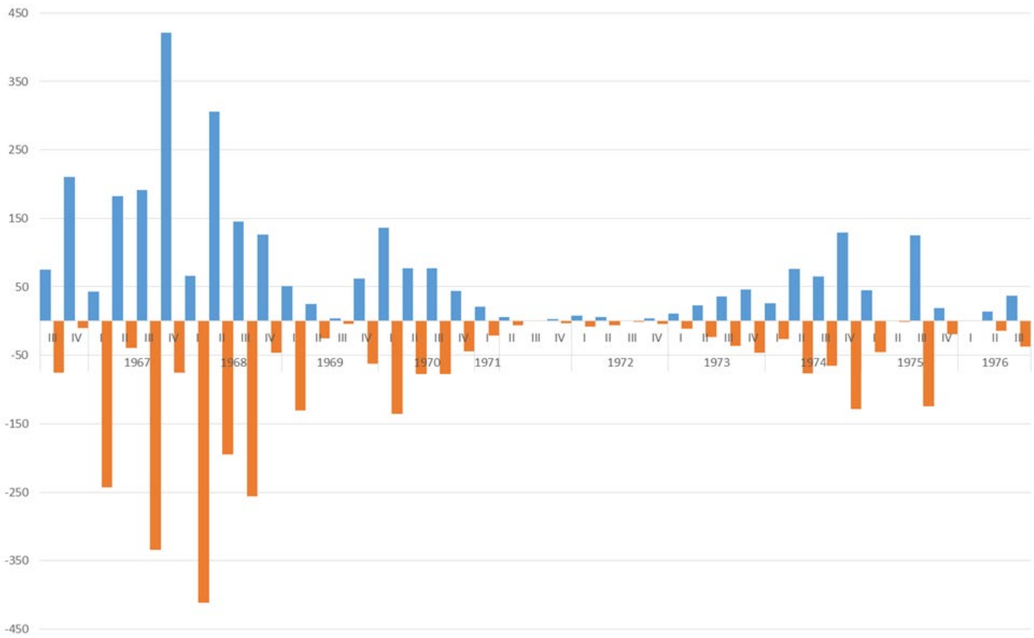
An important but relatively neglected aspect of the swaps is that they were used directly to affect offshore dollar liquidity through banks outside the United States.[25] The details I'm presenting reveal fresh insights from joint work with Bob McCauley, formerly of the BIS (although he may not share my ultimate conclusions).[26] In August 1965, the Fed asked the BIS to set up a separate swap to allow the Fed to channel dollars to the BIS. This became one of the largest facilities in the system, second only to the swap with the Bank of England and equal to the Fed's swap facilities with the Bundesbank. It was large and it was important. From 1966 to 1968, it was used five times to provide dollars for the BIS to deposit in the Eurodollar

[25] This purpose is mentioned by Cooper op cit (2008) and others, but not analysed, eg G Toniolo, *Central bank cooperation at the Bank for International Settlements, 1930–1973,* Cambridge University Press, 2005, p 461; M Bordo, O Humpage and A Schwartz, *Strained relations: US foreign-exchange operations and monetary policy in the twentieth century*, University of Chicago Press, 2015, p 156. In November 1966, the FOMC formally authorised Coombs to tell the BIS that it could draw on the second swap line "if we [BIS] required US dollars to put into the Eurodollar market over the turn of the year and this with the object of damping down a strong rise in interest rates".

[26] R McCauley and C R Schenk "Central bank swaps then and now: swaps and dollar liquidity in the 1960s", *BIS Working Papers*, no 851, April 2020.

market to affect dollar offshore liquidity – at times of political crisis such as the Six-Day War in June 1967 and for seasonal tightening in the market that could disrupt US interest rates in mid-year and end-year. The aim was to avoid a seasonal spike in offshore dollar rates that could tighten up monetary conditions at home.[27] This use of swaps had a motivation similar to those of the 2008 and 2020 swaps, although the technique was different. They were not lender of last resort operations discounting assets of banks, but rather the operations were done through the BIS depositing in commercial banks directly. But the injections amounted to about the same relative value of dollars (about 5% of the total market) and we find that the operations were followed by an easing of the Eurodollar rate and that the participants certainly believed they were working. Graph 7 shows the activity on this swap line, particularly in the late 1960s.

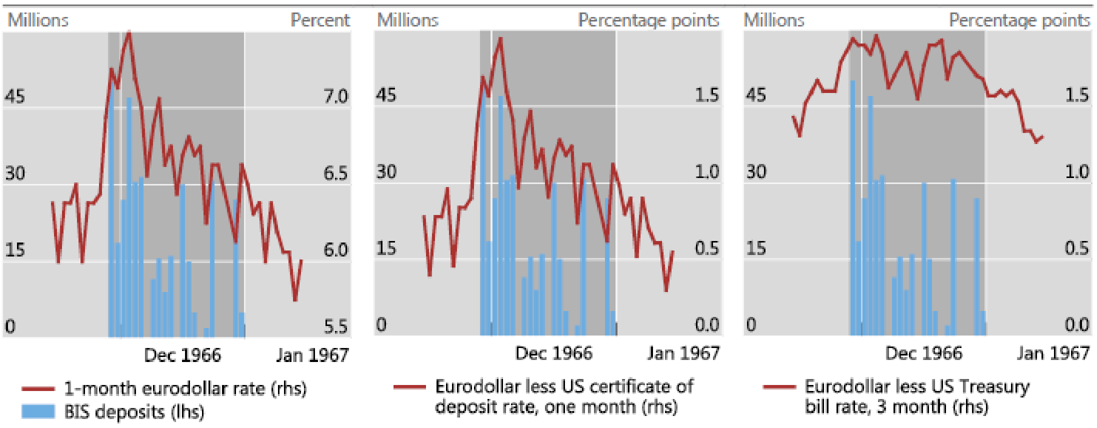
BIS drawings on "second" FRBNY swap (vs DM) Graph 7




Seasonal tightening in the Eurodollar market was of increasing concern in the 1960s. At the November 1966 Gold and Foreign Exchange Committee meeting, Roy Bridge of the Bank of England warned that "This Dec[ember] is going to be tighter than any Dec[ember] in living memory". This inspired Coombs to activate the Fed swap with the BIS to provide dollar deposits in banks outside the United States. The results are shown in Graph 8. The BIS drew $200 million from the Fed swap, added some of its own funds and swapped also with the Swiss National Bank to make about $370 million in deposits. The Swiss National Bank itself deposited about $310 million and other central banks swapped with their domestic banks a further $120 million, bringing the total up to about $800 million.

[27] This use for the BIS swap was generally understood: the Bank of England also referred to the BIS swap against "other European currencies" as specifically "for Euro-dollar operations" when it was increased from $300 to $600 million in November 1967, Bridge Note for Record, 27 November 1967, BoE 10A245-01.

Episode 1: Libid and BIS deposits: November – December 1966 Graph 8




Source: R.N. McCauley and C.R. Schenk, "Central bank swaps then and now: swaps and dollar liquidity in the 1960s, BIS Working Papers, no 851, 2020.

When the Gold and FX Committee reconvened in Basel in the first week of January 1967, the pencil-written notes record that they thought it was a success. Coombs went so far as to suggest that "perhaps [the] BIS Euro$ operation in December is a breakthrough. BIS has operated more or less as a Central Bank in the international money market. [Coombs] Suggests that some agency should assume responsibility for market, especially if Euro-$ market continues to grow".[28] Iklé of the Swiss National Bank and Bridge of the Bank of England remained more circumspect, suggesting that central banks had an obligation "not to cause disturbances in the market" and that, while end-year operations were useful, central banks should not have to monitor or to manage the market year-round.

There were three more successful operations before planning for a final one in December 1968. By this time, Coombs tried to get something more elaborate going, expressing his "hopes that if BIS has to put a lot into the market, it won't be only from Fed. $1 billion [the value of the Fed/BIS swap] a lot of money. Would like others to take part too".[29] Leutweiler of the Swiss National Bank offered that it was "quite prepared to do that with BIS over year end" and Frasca of the Bank of Italy "thinks everyone could contribute". Tungeler also offered that "in a v.[ery] serious situation Bundesbank too would be inclined to step in". Coombs warned that "sudden drying up of forward cover in the market, could trigger off an emergency". This discussion highlights Coombs' anticipation of greater strains in the offshore dollar market as the year-end approached and the need to supplement the BIS swap with simultaneous action by other central banks, partly through the BIS.

If they were so successful, why did these operations stop? This is maybe as important as understanding why they started. Firstly, the Fed's monetary policy stance moved to tightening and so the interventions could conflict with the Fed's domestic priorities. There was an asymmetry to the motivation – it was useful when the Fed wanted interest rates to ease, but not when it was tightening liquidity domestically.

28 Notes of Gold and Foreign Exchange Experts Meeting, handwritten by Dealtry, Basel, 7 January 1967, BISA 7.18(12) DEA20.

29 Notes of Gold and Foreign Exchange Experts Meeting, handwritten by Dealtry, Basel 7 December 1968, BISA 7.18(12) DEA20.

In 1969, the Fed continued its tighter monetary policy and created a barrier between the onshore and offshore markets to impede American banks' channelling of dollar funding from Europe to circumvent tight money at home.[30] Secondly, G10 central bankers came to fear that their own deposits in the market were somehow inflationary and from 1971 agreed not to put their reserves into the Eurodollar market.

Third, we have a change in the US administration. President Richard Nixon, inaugurated in January 1969, swept into the White House with a new foreign policy stance. The patience with swaps was completely exhausted in the run-up to the Nixon shock of 18 August 1971 when he suspended the dollar's convertibility to gold and allowed the dollar to depreciate. In early August, several European central banks as well as the Bank of England asked the Fed to draw on its swaps to get exchange cover against an anticipated depreciation and several (Belgium, the Netherlands, Switzerland) were likely using the dollars to buy gold.[31] The British thought they were just doing what the United States had done before the sterling devaluation of 1967, but the archival evidence suggests that journalists were briefed by the White House to accuse the Bank of England of using its swap to push the dollar off gold. In late 1971, Nixon ruled out any more drawings of dollars under the swap. Coombs tried to breathe life back into the swaps in 1974 and Bodnar in 1975 but it was clear by this time that they could only be used for FX intervention purposes.[32] They were later resurrected as part of the US contribution to the resolution of international financial crises in the 1980s and 1990s.

What I wanted to demonstrate from this trail through the archives (or visit to the sausage factory) is that the 1960s Fed Swaps system had a range of purposes, not just intervention, but also for dollar liquidity, and (as in 2008 and 2020) it was part of the wider global financial safety net although (unlike 2008 or 2020) the operations also included IMF backstops.[33] There are several ideas out there at the moment to expand central bank coordination, partly by extending swaps to more partners and/or involving the IMF.[34] In the 1960s, central bank swaps and deposits were channelled through the BIS as the information-broker and keeper of the ledgers as well as the conduit for operations. Now that the BIS governance structure has adapted better to the shape of global finance, it may be a more desirable locus for pulling together the threads of the broader global financial safety net than it was in 2008.

[30] In October 1969, the Fed imposed a 10% reserve requirement on fresh Eurodollar liabilities for US banks.

[31] Secret memo, 7 December 1971, BoE 10A245-1. The swap was activated on 17 August 1971 at \$2.4197/£ –the following day the rate rose to \$2.60/£, representing a loss of \$60 million. The Fed rolled over the swap and bought back the sterling required at about \$2.45/£, reducing the loss (to Fed/gain to BoE) to \$9 million. Memo to Hallett and McMahon, 15 May 1975, BoE 10A245-1.

[32] Memo for Governor, 8 February 1974. Memo for The Governors, "FRB Swap Line", 12 February 1974. Memo to McMahon by J Sangster, 15 October 1975, BoE 10A245-1. The swaps continued to be discussed by central bankers at Basel.

[33] The BIS swaps had no IMF backstop.

[34] B Eichengreen, "Cultivating global financial cooperation", *Finance and Development*, Fall 2020; C Collins, S Potter and E Truman, "Enhancing central bank cooperation in the COVID-19 pandemic", Petersen International Institute for Economics, 9 April 2020; M Bordo, "Monetary policy cooperation/coordination and global financial crises in historical perspective", *NBER Working Papers*, no 27898, October 2020.

## Conclusions

What can we learn from venturing into the sausage factory? Central bank coordination seemed to operate best in a discreet and confidential environment at the BIS, partly to avoid publicity and parliamentary scrutiny, although central bankers did consult with their Treasury ministers. This was expedient and allowed central banks to extend the global financial safety net in ways the IMF was unable to do (albeit with a democratic deficit). Looking to the 1960s as a heyday of international cooperation, we see that this was a group that did not all have the same interests and frequently disagreed, but they had a commitment to coming to the BIS to foster practical cooperation. The fact that busy central bank governors still make time in their diaries for bimonthly meetings in itself suggests that these meetings must be useful (economists are great optimisers). These qualities continue to distinguish the BIS, even though the cosy club atmosphere may be outdated. In the 1960s, international central bank coordination to manage dollar liquidity was effective but short-lived and prone to the shifting political priorities of participants as well as changing underlying monetary policy goals. Looking at the other parts of the safety net, by the end of the 1960s the British were pushed more firmly in the direction of the IMF backstop when they were unable to repay their short-term credits. Even then, the existence of a final $3 billion Group Arrangement among the G10 central banks to support the ongoing decline of sterling in February 1977 is pretty remarkable.

Most historians would warn against drawing direct lessons from history. As Margaret Macmillan has observed, "the past can be used for almost anything you want to do in the present".[35] It is easy to pick and choose examples that are most convenient or that justify a predetermined course of action. David Cecil's famous quotation – "The past is a foreign country and they do things differently there"[36] – reminds us that appreciating the historical context is important before attempting a translation to the present. Moreover, historians are busy unravelling what we think we know about the past and reinterpreting the causes and effects, so that policymakers need to keep abreast with current historical understanding. Instead of drawing lessons, I hope that greater emphasis might be placed on drawing inspiration from history, moving beyond reaching for the history books only in a time of crisis to looking thoroughly at more mundane periods of cooperation to see what worked and what didn't and why. There are plenty of challenges on the horizon that will require both cooperative and coordinated responses and I hope that you will allow space for history to inspire you in this uncharted territory.

[35] M Macmillan, *The Uses and Abuses of History*, Penguin, 2008.

[36] From his 1949 inaugural lecture for the Goldsmiths chair in literature at the University of Oxford. Later used by his friend L P Hartley at the start of his novel, *The Go-Between* (1953).