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The Exchange Stabilization Fund

Our interest in the topic of this report, the Exchange Stabilization Fund (ESF), originated with announcements in December and January that this fund was to have a role in the U.S. participation in loans to Great Britain. Initial research into the operations of the ESF revealed that little had been written about it and that the ESF published no reports of its activities. These initial findings increased our interest in the ESF, inasmuch as its role seemed to be increasing. Upon further inquiry, we found that the ESF is another Government creation whose function has changed considerably since its inception, whose activities have not been reported to the public (in spite of sometimes being more significant than those of other institutions attracting more attention), and whose control is beyond the reach of Congress. These findings are described more fully below.

Origin of the ESF

On January 31, 1934, President Franklin D. Roosevelt signed into law the Gold Reserve Act of 1934, which enabled him to increase the official price of gold from $20.67 per ounce to $35.00 per ounce. A less widely known provision of this Act created a fund that since has become known as the Exchange Stabilization Fund. Section 10 of the Gold Reserve Act reads in part:

"(a) For the purpose of stabilizing the exchange value of the dollar, the Secretary of the Treasury, with the approval of the President, directly or through such agencies as he may designate, is authorized, for the account of the fund established in this section, to deal in gold and foreign exchange and such other instruments of credit and securities as he may deem necessary to carry out the purpose of this section. An annual audit of such fund shall be made and a report thereof submitted to the President."

Clearly this fund enabled the Secretary of the Treasury to intervene in the foreign-exchange and gold markets, and any actions taken were to be for the stated purpose of stabilizing the exchange value of dollar claims at 35.00 per ounce of gold. This fixed exchange ratio would establish fixed exchange ratios between dollar claims and any other currency specified in terms of gold.

Subsection (b) of section 10 provided the funds with which the Secretary of the Treasury could act under subsection (a). We quote subsection (b):

"(b) To enable the Secretary of the Treasury to carry out the provisions of this section there is hereby appropriated, out of the receipts which are directed to be covered into the Treasury under section 7 hereof, the sum of $2,000,000,000 which sum when available shall be deposited with the Treasurer of the United States in a stabilization fund (hereinafter called the "fund") *under the exclusive control of the Secretary of the Treasury, with the approval of the President, whose decisions shall be final and not be subject to review by any other office of the United States.* The fund shall be available for expenditure, under the direction of the Secretary of the Treasury and in his discretion, for any purpose in connection with carrying out the provisions of this section, including the investment and reinvestment in direct obligations of the United States of any portions of the fund which the Secretary of the Treasury, with the approval of the President, may from time to time determine are not currently required for stabilizing the exchange value of the dollar. The proceeds of all sales and investments and all earnings and interest accruing under the operations of this section shall be paid into the fund and shall be available for the purposes of the fund." [Emphasis ours.]

The $2.0 billion appropriated to the ESF was a portion of the "profit" obtained on the U.S. Treasury's gold holdings when the official price of gold was increased. Of that $2.0 billion, $200 million was designated the capital of the fund. The remaining $1.8 billion was designated an inactive portion and remained included in the gold stock figures of the Treasury.

The italicized words in subsection (b) indicate that these funds were under the "exclusive control" of the Secretary of the Treasury. Only the President could overrule his decisions about using any of the $2.0 billion; the U.S. Congress in passing this Act temporarily relinquished all control of those funds.

In part (c) of section 10, Congress established the limited life of this emergency fund:

"(c) All the powers conferred by this section shall expire two years after the date of enactment of this Act, unless the President shall sooner declare the existing emergency ended and the operation of the stabilization fund terminated; but the President may extend such period for not more than one additional year after such date by proclamation recognizing the continuance of such emergency."

Extending the Life and Role of the ESF

According to the above provision, the ESF was to remain in use for no longer than 3 years, if the "emergency" continued that long. However, as the situation has been with most Government agencies and departments, the demise of the fund did not occur as originally provided, and the ESF remains active in foreign-exchange dealings today. Moreover, the purposes and operations of the ESF have changed since 1934. Originally established for the defense of the new "price" of dollar claims, the fund later was used to extend loans to other governments needing funds to defend their currencies.

On January 10, 1936, President Roosevelt, recognizing the continuance of the "emergency," exercised his option and extended the authorization of the fund for another year. At the end of that year, however, Congressional approval was needed and received to extend the authority of the ESF another 2 years. This also was done in 1939, 1941, and 1943 by amendments to the Gold Reserve Act of 1934.

During this period (1934-45) the ESF was used for transactions in gold, silver, foreign currencies, and U.S. Treasury securities. Before the advent of World War II, fund assets were used to support the exchange rates of the British, French, Dutch, Belgian, and Swiss currencies. Once the war had started such intervention decreased to almost nothing.

However, in November and December of 1940 the ESF for the first time was used in extending loans to other governments. Loans of $50 million each to China and Argentina were made to help those countries stabilize the value of their currencies. Before making the loan to China, Secretary of the Treasury Morgenthau received unanimous approval for doing so from both the Senate Banking and Currency Committee and the House Committee on Coinage, Weights, and Measures. No vote was taken in either the full Senate or House of Representatives, however. No approval for the later Argentine loan was sought or received. Mr. Morgenthau admitted that this loan was "to a certain extent" a departure from the original purpose of the ESF, but he added, "...we feel definitely that it will help a friendly government stabilize its currency in relation to the dollar and help us in our sales there." A precedent thus was set for utilizing the fund's assets in this manner, and this practice has been followed in the instance of the aid recently given to Great Britain.

A major change in the structure of the Exchange Stabilization Fund occurred in 1945. On July 31, 1945, President Harry S. Truman signed into law the Bretton Woods Agreements Act. Section 7(a) of that Act amended subsection (c) of section 10 of the Gold Reserve Act of 1934 to read: "(c) The Secretary of the Treasury is directed to use $1,800,000,000 of the fund established in this section to pay part of the subscription of the United States to the International Monetary Fund; and any repayment thereof shall be covered into the Treasury as a miscellaneous receipt." This amendment removed the emergency classification of the ESF and the need for Congressional approval for its continuation every 2 years.

From 1945 through 1960, transactions of the ESF largely were limited to supporting currencies of Latin American countries. Exchange agreements with Argentina, Mexico, Chile, Paraguay, and Peru were in force at one time or another during this period.

Supporting the Dollar

Beginning in March 1961, the ESF engaged in foreign-exchange operations in support of the U.S. dollar. In agreement with the central banks of the major European countries, the ESF was used to borrow foreign currencies, which in turn were used to purchase dollars. These purchases of dollars helped prevent the exchange value of the dollar from decreasing further at times when it was under "speculative" attack. The loans were repaid when the downward pressure on the dollar had subsided and the fund could buy the foreign currencies with dollars. Germany, France, Switzerland, and Italy were among the countries that lent the ESF currencies for this purpose.

In February 1962, the Board of Governors of the Federal Reserve (Fed) voted to permit the Fed to participate in reciprocal currency arrangements (known as swaps) with other countries. These swap arrangements were similar to the ESF transactions of 1961, except that they provided for the Fed to borrow the currencies to purchase dollars, and they established virtually automatic borrowing limits. Since then attention has been focused on the Fed's intervention in foreign-exchange markets rather than on ESF's intervention.

ESF Certificates
(Millions of dollars)

Year	*Outstanding June 30*	*Year*	*Outstanding June 30*
1963	$108	1970	-0-
1964	292	1971	$1,242
1965	232	1972	1,424
1966	560	1973	2,934
1967	833	1974	2,364
1968	722	1975	1,451
1969	-0-	1976	1,512

Although there is no way of ascertaining exactly to what extent the ESF was used for supporting the dollar, an idea of the magnitude can be ascertained from the amount of ESF certificates outstanding. ESF certificates are special U.S. Treasury securities held by the Exchange Stabilization Fund. When the ESF borrowed a foreign currency and purchased dollars, it invested those dollars in short-term nonmarketable Treasury securities until such time that it could repurchase the foreign currency and repay the loan. Therefore, changes in the amount of ESF certificates outstanding indicate the magnitude of ESF intervention.

The accompanying table shows that the large increases in such certificates outstanding occurred during fiscal years 1971 and 1973, when they increased $1.2 billion and $1.5 billion, respectively. During those years the exchange value of the dollar was under substantial downward pressure. Interestingly, drawings by the Federal Reserve under the swap arrangements during those periods were substantially less.

Monetizing SDRs

Another development that affected the ESF was the creation of Special Drawing Rights (SDRs) in 1970. On June 19, 1968, President Lyndon B. Johnson signed into law the Special Drawing Rights Act. This Act authorized that all SDRs allocated to the United States or otherwise acquired by the United States would be deposited in the ESF, and that any transactions involving SDRs would be conducted through the ESF. Furthermore, the Secretary of the Treasury was authorized to issue SDR certificates to the Fed against any SDRs that were held by the ESF. As of December 31, 1976, SDR certificates issued to the Fed totaled $1.2 billion.

The Fed's acceptance of SDR certificates is similar to its purchasing U.S. Treasury securities, in that in so doing the Fed creates purchasing media. It is different, however, in that it is not the monetization of Government debt but the monetization of an IMF bookkeeping entry that is the obligation of no entity to pay. By this route the nonsensical SDR has come to "pollute" further the U.S. stock of purchasing media. This eventuality was predicted with confidence when the SDR scheme first was proposed. The monetization of such bookkeeping entries simply is another political gimmick for extracting from the American public by devious means funds that the public otherwise would be loathe to make available for foreign aid.

Loans to Great Britain

In December 1976, the IMF announced that an agreement had been reached to lend Great Britain the equivalent of $3.9 billion. Because the assets of the IMF were inadequate for this loan, these funds were to come from the Group of 10 industrialized countries under the General Agreements to Borrow that these nations signed in 1962. The ESF reportedly would be the source of the funds for the U.S. portion of this loan ($1.1 billion).

Less than one month after the IMF loan announcement, the Bank for International Settlements (BIS) announced that eight nations had agreed to another standby credit for Great Britain. The U.S. portion of this standby agreement is an additional $1 billion. If this BIS-arranged credit is drawn on by Great Britain within 1 year, the U.S. funds will be provided through the Fed's swap arrangements. After the first year, the ESF is to provide any funds required under the standby agreement. These terms probably reflect the position of Fed authorities that swaps are to be used for short-term needs only. As we described above, there are no restrictions on the use of ESF assets.

The potential demand on ESF assets for these two loan arrangements totals $2.1 billion. As of June 30, 1976, the ESF had a negligible $51 million in cash; therefore, the $2.1 billion would have to come from other sources. We can think of three possible sources of these funds: (1) borrowing from the IMF, (2) redemption of some ESF certificates, and/or (3) more monetization of SDRs.

Obviously, the first possible source can be ruled out, inasmuch as the IMF is short of loanable funds. As of June 30, 1976, the ESF held $1.5 billion in ESF certificates that could be redeemed. However, the funds represented by such certificates will be needed to purchase foreign currencies in order to repay previous loans. Moreover, to the extent that such certificates are retired, the Treasury will have to sell more securities in the private capital market.

The third alternative is a further monetization of SDRs. As of June 30, 1976, the ESF held $2.3 billion in SDRs that could be monetized, and this total, or any part thereof, could be monetized on demand by the Secretary of the Treasury. This seems to be the most probable source of funds for any calls on the ESF to meet U.S. commitments to Great Britain.

Summary

When the ESF was created in 1934, tremendous powers were granted to the Secretary of the Treasury. He was granted complete control over the $2 billion made available for the fund. The purpose of the ESF to stabilize the exchange value of the *dollar* was clear, but the Secretary of the Treasury could do this in any way that he deemed appropriate.

For 6 years the original purpose of the fund was adhered to, but in 1940 the Secretary of the Treasury began a policy of using ESF assets to extend loans to foreign governments. Although clearly *not* a function of the fund this policy has been a major function of the ESF since then. The Secretary of the Treasury's power thus was increased further.

The creation of SDRs in 1970 and the allocation of the U.S. share to the ESF substantially increased the assets of the fund. The Secretary of the Treasury now has more funds with which to operate, inasmuch as he can have any or all SDRs monetized by the Fed on demand. Furthermore, he is not limited by the amount of these assets. He has authority to use the ESF to borrow foreign currencies with which to buy dollars, and he has done so. The activities of the ESF are not reported by the Government; therefore, analysts have no way of knowing the extent of U.S. intervention in the foreign-exchange markets. The secretive nature of the ESF is inconsistent with the principle that the American public has a right to know what its Government is doing.

STATISTICAL INDICATORS

Among the primary leading indicators of business-cycle changes, the average workweek of a production worker in manufacturing decreased during December and January. The 3-month moving average of this series decreased slightly during December, which suggests that the increases in this series during October and November might have been only a temporary interruption of the cyclical contraction that began in February. Thus, the cyclical status of this series remains appraised as probably contracting. The inverted layoff rate in manufacturing increased during the 3 months ended in December, and the 3-month moving average of this series increased during November. These developments introduced doubt that the cyclical contraction of this series, which began last February, has continued. The percentage of primary leaders appraised as expanding cyclically remains 50.

The number of persons employed in nonagricultural establishments increased during January to a record, and this series continued to expand cyclically then. The percentage of primary roughly coincident series so expanding remains 100.

Among the primary lagging series, the inverted average duration of unemployment was unchanged during December and increased during January. The moving average of this series has decreased for 3 months, and there is some doubt that this series has continued to expand cyclically. The composite of short-term interest rates increased slightly during January after decreasing during the preceding 6 months. It is appraised as contracting cyclically. This is the only primary lagger not appraised as expanding cyclically. The percentage of primary laggers so appraised remains 83.

That only 50 percent of the primary leading indicators are appraised as expanding cyclically warrants some doubt that the business-cycle expansion will continue. However, there is not sufficient evidence to warrant the conclusion that a cyclical contraction of general business activity will continue.

BUSINESS

EMPLOYMENT AND UNEMPLOYMENT

Note: All data are seasonally adjusted.

Employment conditions from the point of view of employees deteriorated somewhat on balance during the fourth quarter of 1976 from those during the preceding quarter. Selected employment data (averages of monthly data) are shown in the accompanying table for the fourth quarter of 1976, and for the preceding and year-earlier quarters.

Of the major indicators of employment conditions prepared by the BLS (Bureau of Labor Statistics), deterioration of employment conditions during the final 3 months of 1976 was indicated by an increase in the number of unemployed persons, increases in the unemployment rates for most groups of workers, and a decrease in the employment ratio.

Some improvement in employment conditions was indicated by an increase in the number of employed persons (household survey), an increase in the number of persons on nonagricultural payrolls (establishment survey), and by increases in the average workweek of production workers in manufacturing and in the average of overtime hours for such workers. However, the average workweek,

SELECTED EMPLOYMENT DATA
(Quarterly Averages of Monthly Data)

Series	*1975 Q4*	*1976 Q3*	*1976 Q4*
Number of persons on nonfarm payrolls*	77,592	79,344r	79,708p
Number of unemployed persons*	7,912	7,439	7,632
Avg. workweek for production workers in mfg.	40.0	39.9	40.0p
Avg. overtime hours in mfg.	2.9	3.0r	3.1p
Participation rate	60.3	61.0	61.0
Employment ratio	55.2	56.2	56.1
Nonagricultural emp. ratio	53.0	54.1	54.0
Unemployment rates			
All civilian workers	8.5	7.8	8.0
Adult men	7.0	6.0	6.3
Adult women	7.9	7.6	7.6
Teenagers	19.5	18.8	19.0
Married men	5.1	4.4	4.4
White persons	7.8	7.1	7.3
Nonwhite persons	14.0	13.1	13.6
Avg. duration of unemployment†	16.5	15.6	15.6

Note: All data are seasonally adjusted.
p Preliminary. r Revised. *In thousands. †In weeks.

which is a primary leading indicator of business-cycle changes, remains appraised as contracting cyclically. Before rounding, the fourth-quarter increase in the quarterly average was only 0.07 hour, and the preliminary estimate of the average workweek for January 1977 was equal to the 39.7 hours reported for September 1976. This was 0.7 hour less than the January 1976 high during this cycle and the shortest average workweek since then.

Although employment data for January recently were released, most analysts believe that the data for that month (and probably those for February and March) reflected (and will reflect) the effects of the adverse weather conditions. For example, the January survey of households (which was conducted during the week of January 9 to 15) revealed a decrease of 444,000 in the civilian labor force, resulting from a marked decrease of 561,000 in the number of unemployed persons and an increase of only 117,000 persons in the number employed. Because a person must have been actively seeking employment to be counted as unemployed, the decrease in the number of persons so counted may be attributable to curtailed job-seeking activities during winter storms. Moreover, the January survey was compiled before natural gas shortages resulted in many plant closings in some states. This situation could result in further anomalies in the employement data if February data reflect such closings or if plants re-open soon and lost production is "made up" during February and March. Therefore, the significance of the recent employment data is unclear, and conclusions about first-quarter employment conditions probably will not be warranted until spring, if then.

The participation rate during the fourth quarter of 1976 was unchanged from that during the preceding quarter, which was a post-war record of 61.0. (The participation rate is the proportion of the noninstitutional population age 16 and over that is employed or seeking employment.) As we have asserted in earlier employment reports, that the unemployment rate currently is high compared with those during earlier cyclical expansions probably reflects the record participation rate more than it does general business conditions. Therefore, for the Government to attempt to stimulate employment by fostering higher aggregate demand would seem to be an unwise policy.

CHARACTERISTICS OF UNEMPLOYED PERSONS
December 1976

	Number (millions)	*Percent*
Household heads*	2.2	29
Living alone	0.7	9
Others	4.6	62
Total	7.5	100
Lost last job	3.7	49
Quit last job	0.8	11
Re-entered labor force	2.0	27
Seeking first job	1.0	13
Total	7.5	100
Seeking work 27+ weeks	1.4	18
15 to 26 weeks	1.1	15
5 to 14 weeks	2.3	31
Less than 5 weeks	2.7	36
Total	7.5	100

*Relatives present.

Some of the characteristics of the 7.5 million persons estimated to have been unemployed in December are shown in the accompanying table. The data in the table do not require extensive comment. However, readers might note that 62 percent of the unemployed were persons such as wives or children living at home whose earnings might not be necessary for the financial maintenance of their households. An additional 9 percent of the unemployed live alone, i.e., do not have dependents. These data do not support the popular image of an unemployed person as someone who lost his job (less than half did) and must provide for his family (71 percent do not have such obligations) and who cannot find employment even after a prolonged search (two-thirds of the unemployed have been looking for work for less than 15 weeks). We do not suggest that there are no such persons; we only suggest that their number is far fewer than the widely quoted estimate of the number of unemployed persons.

Employment conditions from the point of view of employees deteriorated slightly during the fourth quarter of 1976. The severe winter weather in some sections of the Nation probably will distort employment data during the next few months and make an accurate assessment of underlying employment conditions then nearly impossible.

DEMAND

RETAIL SALES

Estimates of retail sales during the most recent week and 4 weeks compare with such sales during the corresponding periods a year earlier as follows:

Period	*Percent change*
Week ended January 29	+5
Four weeks ended January 29	+7

OPENING FOR STAFF ECONOMIST

We have an opening for a staff economist. Applicants should be well trained in economics and mathematics, should be familiar with scientific procedures, and should be skeptical of economic dogma. Advanced degree holders are preferred. If qualified, and interested, send resume and writing sample to the Acting Director.

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