PRESS REPORTS

Business Week
New York
November 10, 1962

International Liquidity--The Great Debate

Conservative faction, headed by Per Jacobsson of IMF and Robert V. Roosa of U.S. Treasury--with the support of most European central bankers--want to move slowly in reshaping international payments system based on U.S. dollar as reserve currency.

More radical approaches are urged by Britain's Chancellor of the Exchequer, Reginald Maudling and Yale economist Robert Triffin. Maudling wants system of "special credits" at IMF that could ease recurrent sterling crises. Triffin, would turn IMF into an international central bank.

DOES IMF HAVE THE MUSCLES?

Triffin school of economists doubts that the present system is adequate to supply the financing needed for growing trade in the free world.

Bland confidence in the dollar, and in the system of international payments based on it, was the keynote when the high priests of international finance met in Washington eight weeks ago for the annual convocation of the International Monetary Fund [BW Sep. 22 '62, p. 35].

By now, this confident mood has changed, with the bearish switch in the outlook for the balance of payments [BW Nov. 3 '62, p. 114]. The U.S. has suffered substantial losses of gold, in part due to the Cuban crisis: our reserves have fallen below $16-billion for the first time since 1939.

The change has brought renewed attention to the plans devised by the industrial giants of the free world to handle international payments in the financing of trade. Many are questioning whether the arrangements--based on the dollar and the pound as reserve currencies with the IMF as a supplement--are adequate for the needs of the 1960s. The old debate over international liquidity, which last came to a head at the Bretton Woods Conference in 1944 when IMF was created, is cooking briskly again.

Definition. International liquidity, in the very simplest terms, is the total of all gold and foreign exchange holdings by governments and central banks. For the whole free world, IMF figures this as roughly $61.2-billion, up about 25% since 1951. Foreign holdings of U.S. dollars account for more than half of the growth.

To perform its essential function, this hoard must be large enough and well enough distributed to allow individual nations to finance seasonal and cyclical swings in their international trade. It must also cushion disruptive flows of capital in the international money market. In practice, these functions mean that the dollar and the pound, as the principal reserve currencies, must be strong and stable.

I. What is Enough?

The debate that is again bubbling so actively centers on whether the $61-billion is adequate to its task--in composition, in size, and in its rate of growth. The sum of world trade is growing much faster than the sum of world liquidity. World exports--excluding the Communist countries--has risen more than 64% since 1951, more than twice as fast as the increase in gold and currency reserves.

Moreover, despite the fact that new gold is being mined at the rate of $1.2-billion a year, official gold holdings have leveled off this year because of two factors:

Private hoarding (which in 1961 took an estimated $350-million out of circulation) has apparently taken a sharp upward turn.

Russian sales, a major source of gold for the West in postwar years, have suddenly stopped.

To a growing band of economists, led by Yale's Robert Triffin, the disparity in growth rates is a clear and present threat to the financial stability of the West.

The Triffin supporters argue that over the long run the comparatively slow climb of liquidity will act as a drag on economic growth. Essentially, they apply to the international sphere the old economic proposition that a nation, to grow, must have a money supply--currency and demand deposits in its banking system--that expands in close proportion to the real growth in its national output. They also claim that world liquidity, including the $17-billion available to IMF to aid nations in distress, may not be enough to handle a major currency crisis, such as a run on the dollar.

'Insufficient Supply.' Triffin puts it this way: "The most fundamental deficiency of the present system and the main danger to its future stability lies in the fact that it leaves the satisfactory development of world monetary liquidity primarily dependent on an admittedly insufficient supply of [newly mined] gold and an admittedly dangerous and haphazard expansion in the short-term indebtedness of the key currency countries."

Triffin is the intellectual descendant of John Maynard Keynes and his plan for an International Clearing Union--an international central bank that could create a new kind of world money, called "bancor." Keynes' plan was the basis of the British proposal that was rejected at Bretton Woods. The conference chose to set up IMF simply to pool part of the members' gold and currency reserves to be available for loans to members in short-run balance-of-payments trouble.

Close to Keynes. Triffin would follow the Keynes model rather closely, with some important technical changes to eliminate objection raised at Bretton Woods. Deposits at his revamped IMF, like Keynes bancor, would supplant the dollar as the basis for liquidity. Others in the Triffin camp have suggested a flock of variations. Maxwell Stamp, former British director of IMF and now a director of the London banking house of Philip Hill, Higginson, Erlangers, Ltd., suggested quite a different approach back in 1958. Stamp proposed that IMF be empowered to create credit, geared to channeling aid to underdeveloped areas rather than meeting the needs of over-all liquidity.

This September, at the IMF meeting, a system of "special credits" was proposed by Reginald Maudling, the Chancellor of the Exchequer. Countries with a balance-of-payments surplus would deposit the excess at IMF, guaranteed in terms of gold. There it could be drawn on by nations facing a deficit.

Maudling would stop short of empowering IMF to create credit. Indeed, his plan's most important consequence might be to make intermediate term credits available to a country undergoing basic economic adjustments, as Britain is likely to do if it joins the European Economic Community. But the IMF deposits would take on many of the characteristics of an international currency that could be traded among central banks.

II. The Official Position

Triffin's ideas are energetically opposed by Per Jacobsson, who will retire soon as head of IMF, and Treasury Under Secy. Robert V. Roosa, chief financial strategist for the Kennedy Administration. Virtually all the central bankers in the EEC support the Jacobsson-Roosa view.

The objections to Triffin range from the facetious remark of Dr. M. W. Holtrop, head of the Netherlands central bank, that he would object to any system making him "technologically unemployed," to Jacobsson's fundamental point that there is no meaningful analogy between the growth essential to a nation's money supply and that required for international liquidity.

The essence of all the objections is that individual central bankers are loath to surrender control of their international monetary reserves, and this surrender is implicit in Triffin's proposal, though not in Maudling's.

Jacobsson summed up his position last week for the National Foreign Trade Council: "The two concepts of liquidity [national and international] must be clearly distinguished, for otherwise confusion is bound to arise . . . As trade increases--either domestic or foreign trade--enlarged credit facilities are required in national currencies to ensure adequate financing. Trade is, of course, financed in national currencies, and foreign trade is financed largely in the currencies of the main industrial countries. Thus, an expansion in foreign trade is financed through the credit mechanism in individual countries . . . [and] an increase in the credit volume can occur without an addition to monetary reserves . . . There can be no question of any inherent parallelism between the expansion of credit and the growth of reserves."

<u>Reasonable Confidence.</u> Jacobsson is saying in effect that there can be no shortage of liquidity so long as there is reasonable confidence in the currencies of the leading trading nations, giving traders adequate access to import-export financing. Nevertheless, Jacobsson is clearly concerned

that deflation is the No. 1 problem facing the West, and some of his critics raise the question whether this deflation may not be related to monetary problems.

An IMF economist adds that "there are potential sources of credit in Europe to finance world trade that are virtually untapped at present. What would happen if a liquid market for bankers' acceptances (traditional financing for trade) developed in the Common Market? There's none today, and as the European economies grow, the need for this kind of almost riskless investment is bound to grow."

Roosa goes beyond Jacobsson's analysis, pointing to the whole series of innovations in international finance that have been put into effect over the past 21 months. These moves have been primarily to defend the dollar but, because the dollar is the cornerstone of the IMF system, they have had an important bearing whether international reserves are adequate.

Intervention. The U.S. is intervening substantially in the foreign exchange market, in the hope it can choke off speculative currency runs before they can snowball and thus limit the reserves needed as a hedge against crisis.

Just last month, Pres. Kennedy signed the $2-billion appropriation for U.S. membership in the new $6-billion "Lender's Club" [BW Dec. 23 '61, p. 26]. In the club, 10 major industrial nations--including the EEC countries, Britain, and Japan--agree to pool their resources to shore up the currency of any member facing serious trouble. These loans, which could run up to five years, would supplement, not supplant, IMF.

In addition, the Federal Reserve, by a series of currency swaps with the central banks of Canada and all the major European nations--not to mention some of the smaller ones--has laid in ammunition for its currency operations. Most of the swaps are on a standby basis.

The Latest. Most recent and possibly most important for the long run is Roosa's liquidity plan, announced in Rome last spring. For all practical purposes it has become official U.S. policy, and for the first time the U.S. is starting to add foreign exchange holdings in its monetary reserves, just as other nations hold the dollar as backing for their currencies.

Roosa reasons that the biggest single contribution to the growth of international liquidity is the deficit in the U.S. balance of payments, which has led to an increase to well over $20-billion in the dollars held abroad. So, if the U.S. began to run a surplus, the situation would reverse itself; if the U.S. tried to recapture the gold and dollars that have gone abroad, liquidity would contract.

By proposing to acquire foreign currencies, Roosa has in effect committed the U.S. not to reclaim its lost gold and dollars. So far, these foreign currency holdings haven't amounted to much--less than $500-million. But if the U.S. balance of payments should swing into persistent surplus, the holdings could bulk large in U.S. monetary reserves, now virtually all in gold.

No Limit. A high Treasury official says: "There is no a priori limit to the quantity of convertible foreign exchange that the U.S. will acquire --without guarantee against devaluation--when our balance of payments moves into the black."

So far, there has been little criticism of the Roosa Plan. Privately, though, some European and American bankers are saying that it amounts to a case of "monetary incest." Today, they say, the IMF is based on the dollar, which in turn is based on gold. But if the dollar were based on a polyglot portfolio of foreign exchange, they want to know, what you have then?

The U.S. takes the position that its policies--plus closer cooperation all around among central bankers--should be enough to keep the Western payments system on an even keel for the foreseeable future, and to provide adequate financing for international trade. "As of now," a U.S. official adds, "I think the burden is on those who don't like the present system to provide some really workable alternatives."

III. A Matter of Risk

Underlying the whole liquidity debate is the desire to eliminate the risk that is inherent when one nation holds the currency of another as part of its official reserves. Both the dollar and the pound have been devalued within the past generation, yet they are still accepted as reserve currencies by most central bankers.

Triffin and Maudling would meet the problem by bringing international reserves under the wing of IMF, with its built-in guarantee against loss in case the U.S. should raise its gold price. Here's how that guarantee works: Under present arrangements, if the U.S. doubled its gold price, a nation that had supplied dollars to IMF would get back twice what it had contributed.

The case for a gold guarantee is summed up more simply by Xenophon Zolotas, Governor of the Bank of Greece: "To insure perfect substitutability between the reserve currencies and gold, central banks should not only be able to convert the former into the latter freely and unconditionally, but should also have a definite guarantee of the gold content of their foreign exchange reserves. This is the only way to eliminate a major source of concern to central banks . . ."

Contradiction. At this point, the Roosa-Jacobsson axis balks. For Roosa, the whole case for the guarantee rests on a contradiction. In giving such a guarantee, he argues, the U.S. would probably eliminate doubts about the dollar as a reserve currency. This would leave the Administration free to lower interest rates sharply and to increase its deficit spending to stimulate the economy. But such policies would be precisely the sort that could destroy foreign confidence.

Roosa then asks: "How close might our position then seem to be to that of a debtor approaching receivership with tier upon tier of first, second, and third mortgage claimants to satisfy?" Besides, he adds, "the U.S. abrogated a gold clause once [before] . . . what assurance can a mere guarantee provide again?"

The real basis for confidence in the dollar, Roosa concludes, does not lie in any system of guarantees, no matter how solemn and binding. Rather, he says, it is in "the strength, performance, and creditability of the American economic and financial system . . ."