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Issues in the International Liquidity Debate

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Ralph C. Wood

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As we all know, international liquidity and the international monetary system, subjects of growing interest and concern during the past five years, have been under intensive study during the past twelve months. At the annual meeting of the International Monetary Fund in Washington a year ago, ten leading countries announced that they would undertake "a thorough examination of the outlook for the functioning of the international monetary system and of its probable future needs for liquidity." At the same time the Managing Director of the IMF indicated that the Fund would enlarge and intensify its own studies in this field. And three economists attending the meeting as guests decided to organize an academic group, which would include members from all countries in the Group of Ten, to study the same general subject.

By the time of this year's annual meeting, held in Tokyo just last month, the formal results of the work of all three bodies up to that time had been made known. The Ministers of the Group of Ten had issued a statement, which was published together with a summary of the main results of a more detailed report prepared by their Deputies after exhaustive discussions in a series of monthly meetings throughout the year, held usually in Paris.1/ In two chapters of its latest Annual Report the IMF had reported on its work.2/ And the International Study

* A paper prepared for the Committee on Financial Analysis of the Federal Reserve System and presented at a meeting of this Committee in Cleveland, Ohio, October 27, 1964.

1/ <u>Ministerial Statement of the Group of Ten and Annex Prepared by Deputies, issued August 10, 1964</u>.

2/ International Monetary Fund, <u>Annual Report of the Executive Directors for the Fiscal Year ended April 30, 1964</u> (Washington, D. C., 1964).

Group of private economists had also reported on its studies, in a small volume published in August.[3/] At Tokyo, the subject to which all these studies had been addressed was the focal point of the IMF agenda and discussion.

As you know, Under Secretary Roosa and Governor Daane were the U.S. members of the Group of Deputies of the Ten, and Mr. Roosa chaired that Group.

Results of the studies

I think the report of the private economists need not take up much of our time, and might best be disposed of first. It was not the primary purpose of the International Study Group to reach agreement on a practical program. The main purpose the Group set for itself was rather to try to determine the reasons for the wide differences among academicians in their prescriptions for international monetary reform. The reasons for these differences were largely sought in differences in underlying assumptions. The resulting study is certainly unusual, if not unique, and for anyone with a strong interest in these matters is well worth reading. The fact that it contains no startling conclusions or no strikingly new proposals is no reflection on the study. While this lack may be due in part to the nature of the study, it probably reflects mainly the fact that all possible solutions of the international liquidity problem were already known, and there are no simple answers to the difficult problem of choice which is involved.

3/ International Monetary Arrangements: The Problem of Choice. Report on the Deliberations of an International Study Group of 32 Economists (Princeton, 1964).

The International Study Group had made it clear that the range of proposals it would consider would include, among others, the alternatives of flexible exchange rates and a change in the price of monetary gold--both of which had been excluded at the outset by the Group of Ten--and some of the academicians may have had hopes that while the purpose of their study was not primarily to seek agreement among themselves, their group would in fact be able to agree to recommend one or the other of these possible courses of action. In the event, however, those possibilities figure in the study only as two of four alternatives considered: the semi-automatic gold standard (with a change in the present price of gold); centralization of monetary reserves; a system of multiple currency reserves; and a system of flexible exchange rates.

We may now turn to the two official studies, that of the IMF and that of the Group of Ten. Presumably, everyone is at least generally familiar with the IMF: what it is and what it does. The Group of Ten consists of ten leading countries: the United States, the United Kingdom, Canada, Japan, Sweden, and the five major member countries of the European Common Market. This Group was organized in 1962, when it established in the IMF what are known as the General Arrangements to Borrow: arrangements under which the IMF may under certain circumstances, in order to be able to assist one or more members of the Group, borrow from other members up to specified amounts of money in their own currencies. Included in this Group are those countries whose actions are largely responsible for the successful functioning of the international payments system of the free world. When studies of this system were being planned last year, it seemed natural to have one made by these countries; and the Group of Ten was an obvious framework for it. It should be added that after the General Arrangements to Borrow were established, Switzerland became a supplementary participant, and has also had observer status in the Group of Ten liquidity discussions of the past year; so in a sense the Group of Ten is really a Group of Eleven, even if not formally so.

It is an important fact that each of the two studies we are now considering was able to reach definite conclusions on a number of important points, and also that on the main points the conclusions reached by the two studies were substantially identical. Let me state these agreed conclusions as briefly as possible.

First, both studies agreed that the existing international monetary system has worked well thus far, in that it has shown a capacity for adaptation, has facilitated economic growth, and has withstood periods of considerable strain.

Second, both studies confirmed the general judgment made at the IMF annual meeting in 1963 that for the time being, at least, international liquidity is adequate.

Third, both studies recognized that "continuing growth of world trade and payments is likely to entail a need for larger international liquidity in future. This need may be met by an expansion of credit facilities and, in the longer run, may possibly call for some new form of reserve asset." (Language of the Ministerial Statement of the Group of Ten.)

Fourth, both studies also recognized that in the provision of international credit facilities, at least, the IMF occupies a central position. Several interrelated conclusions were reached regarding the

Fund. One was that a moderate general increase of quotas next year--say of 25 per cent--would be appropriate and desirable. Another was that some individual quotas should also be adjusted. In connection with both types of quota increase, it was also understood that efforts would be made to minimize the impact of gold payments on country reserves, particularly those of the reserve-currency countries. And it was recalled that under the terms of the General Arrangements to Borrow, some decision will have to be taken by October 1965 regarding the status of these arrangements after October 1966.

Fifth, both studies concluded that systems for the creation of new reserve assets should be studied further. The Group of Ten has established a special Study Group for the purpose; and the IMF will cooperate with the Group of Ten study, while also continuing its own.

Sixth, recognizing that the rate at which and the process by which significant balance-of-payments deficits and surpluses are corrected has an important bearing on international liquidity needs, both studies concluded that these matters should also be studied further. At the invitation of the Ministers of the Group of Ten, Working Party No. 3 of the OECD (Organization for Economic Cooperation and Development) will study this subject.

In addition to these points of substantial agreement between the two reports, another important point emerging from the Group of Ten study is the understanding regarding "multilateral surveillance." With a view to subjecting deficit countries to a stronger discipline, some of the European countries had urged establishment of a kind of collective supervision of the use of existing facilities for the financing of external imbalances, and of the creation--whether multilaterally or bilaterally--of new facilities. But as the Chancellor of the Exchequer of the United Kingdom pointed out at Tokyo, what was agreed upon "does not give any member of the Group of Ten, or indeed the Group as such, a veto on the setting up of new facilities within the Group or between members of it, or on the use of existing facilities." What was agreed upon was essentially the regular exchange of information on methods of financing--information which the United States had in fact already been supplying to especially interested countries--and discussion, as necessary, of these methods of financing.

Thus far it may seem that the studies and discussions of the past year have been characterized by a high degree of agreement among the participants. As has been publicly known for some time, however, and as was confirmed by the Tokyo discussions, some European countries have views on these matters which differ rather sharply--especially as to what arrangements would be most appropriate for the future--from those the United States and the United Kingdom have been developing. I shall get to these differences in a moment.

The studies of the past year, and the Tokyo discussions and decisions resulting from them, have come in for criticism in some quarters, as having accomplished little, and as allegedly constituting the feeble results that might have been expected from a compromise between sharply differing approaches. This criticism seems to me unjustified, for two reasons.

First, it would be a mistake to under-estimate the significance of what has already been agreed. The Ministerial Statement of the Ten states flatly that "the continuing growth of world trade and payments is likely to entail a need for larger international liquidity." And it openly recognizes the possibility that this need "in the longer run may possibly call for some new form of reserve asset." Such statements reflect a marked change in official thinking within a relatively short time. The decision to recommend a general increase in IMF quotas is also important, because even a 25 per cent increase would be sizable (as it would amount to the equivalent of $4 billion), and also because it would be the second general increase of quotas in little more than five years, there having been one of 50 per cent in 1959.

In the second place, while it is undoubtedly true that the results achieved thus far have been strongly influenced by the wide differences that exist in approaches to the problem, a case can be made that decisions should not have been pushed much faster even if there had been a unanimous view as to the nature of the problem and what should be done about it in the long run. All too often, people tend to take the substantial stability of economic life for granted, and to forget that both the level of economic activity and the stability of various elements of the economic system are vulnerable to sudden shocks, which could be caused by too-rapid change in institutional arrangements as easily as by political or economic developments or by acts of God. Thoughts of this sort must have been in the mind of M. Giscard d'Estaing, the French Minister of Finance, when he said at the 1963 IMF annual meeting:

> ... I do not want us to give in to this kind of intellectual nomadism by virtue of which one tries to escape from an existing system as soon as weaknesses become apparent in it, while forgetting the substantial benefits that it has brought, and the perils which it has helped avoid. 4/

4/ International Monetary Fund, Summary Proceedings 1963 (Washington, D. C., 1963), p. 60. Underlining added.

There is no rush. In official circles, at least, there is general agreement on the adequacy of international liquidity at present. There is time to feel our way, and to take action only when we are sure it is necessary, and will not unduly rock the boat. Provided there is willingness to ask the right questions and to face the right answers, it can reasonably be assumed that institutional arrangements will evolve in the right direction; and that, it seems to me, is what mainly matters.

The issues

I should like now to try to sort out some of the main issues involved in our subject. While certain questions have been settled by the work of the past year, many others remain, and some of them are very difficult. This means that in all probability we shall be hearing about international liquidity and the international monetary system for some years to come. The better our grasp of the underlying issues, the easier it should be to follow this continuing debate as it develops, and if progress is slow, to understand why.

I shall concentrate on issues that are still outstanding, and shall not attempt to review all the main questions that have come up in the course of the international liquidity debate. An example of the kind of question which has been debated, but which it seems unnecessary to explore here in detail, is the question whether international liquidity need rise in roughly the same proportion as international trade. This received quite a bit of attention in newspaper and magazine articles about a year ago. At that time many people interested in international liquidity were discovering for themselves, and were busy explaining in print, that the need of any individual country for international reserves and other forms of international liquidity was a function of the balance-of-payments deficits to which it might be subject, rather than to its foreign trade volume as such.

Different conclusions were drawn from this fact; but in general, there has been growing recognition that the magnitude of potential deficits bears no simple relation to any other single magnitude. Deficits are related not only to the volume of trade but also to the degree of freedom of trade; but they may be related, and in some cases are related, even more importantly to capital movements, which may be highly volatile.

To the best of my knowledge, no one has a satisfactory answer to the question whether the need for international liquidity is or is not likely to rise more or less in line with the rise in international trade. But I think a kind of tacit consensus has been reached that since most economic and financial magnitudes rise over time, the safest assumption to make about future needs for international liquidity is that they too are likely to grow. In its 1964 Annual Report the IMF said that "a larger world economy with larger world trade is likely also to involve greater absolute payments disequilibria."[5/] Similarly, the Deputies of the Group of Ten said that "while there appears to be no convincing evidence that imbalances will be longer-lasting or more intractable than hitherto in the postwar period, a rising turnover of current and capital payments is likely to entail some increase in the size of fluctuations."[6/]

5/ International Monetary Fund, 1964 Annual Report, p. 29.

6/ Ministerial Statement of the Group of Ten and Annex Prepared by Deputies, p. 9.

Thus, uncertainty as to the exact magnitude of future needs for international liquidity does not appear to be among the more important obstacles to further changes in international liquidity arrangements.

There are other examples of what might be called "background" issues, such as the question whether monetary gold supply is or is not likely to rise sufficiently to meet the rising need for international liquidity; but I think we should now proceed to the unsettled issues that have stood out most in the Group of Ten work during the past year. According to published reports, as you probably know, the main conflict of view has tended to be between the United States and the United Kingdom, on the one hand, and France and the Netherlands, on the other. While there is some truth in these reports, it would be wrong to think that the French and Dutch have no support from other participants in the Group of Ten discussions. On the other hand it would also be wrong to think that the French and Dutch are merely acting as spokesmen for a unified European view.

One reason for the bipolar tendencies in these discussions is that France has strongly supported a particular plan for international monetary reform which, if adopted, could profoundly influence the international monetary system as a whole, and the status of the U.S. dollar in particular. It will be useful to consider this plan, partly because it is of interest in itself, but primarily because it poses, explicitly or implicitly, most of the main issues of our subject that are still unsolved.

The plan the French have opted for is based on an idea put forward by E. M. Bernstein, formerly director of research at IMF, a year or so ago. This idea involves the creation of a new currency unit, to be known as the Collective (or Composite) Reserve Unit (CRU). Each participating country would buy, with its own currency, its prescribed quota of CRU's. In the French version, each country's quota would be fixed by the relation between its gold reserves and the total gold reserves of all participating countries. Suppose the total gold reserves of the group were $30 billion, and the equivalent of $6 billion worth of CRU's were to be created. If Country A's gold reserves were $3 billion, or 10 per cent of the total, its CRU quota would be $600 million, i.e. 10 per cent of $6 billion. Subsequently, each participating country would maintain holdings of $1 in CRU's for every $5 in gold. Thus transfers of gold to settle imbalances would be supplemented by transfers of the new unit, in this same proportion of 5 to 1. Of course, the proportion could change. The presumption is that over time the ratio of CRU's to gold would rise, but only by agreement among the participating countries.

This brings up another important aspect of the CRU plan in its French incarnation. This is the fact that the unanimity rule would apply: not merely to the initial establishment of CRU's, but also to all future increases or decreases in the aggregate amount of CRU's in existence.

At least five main issues arise from this plan, or are involved in it. They are as follows:

first, whether a new system for the creation of "owned" reserves is necessary, or whether future needs for additional international liquidity can and should be met largely through the expansion of international credit facilities;

second, if a new system for creating owned reserves is necessary, whether it should be the CRU plan as proposed by the French, or something else;

third, whether the reserve-currency system should be retained, and, if so, whether a CRU system would be likely to permit this;

fourth, what the role of bilateral credit accommodation should be in the future;

and fifth, how much emphasis should be placed in future on rapidity of balance-of-payments adjustment.

Let me try to explain each of these issues, indicating the position taken thus far by the United States.

The first issue is whether a new system for owned-reserve creation is necessary, or whether future needs for international liquidity can and should be met largely through the expansion of international credit facilities. Here I might begin by saying something about the meaning of "owned reserves." Ideally, international reserves that are truly "owned" by a country have two essential characteristics: first, their use is at the unconditional option of their owner, meaning that the owner can expend them when, where, and for whatever reason or purpose he wishes (apart from conversion into gold, which may or may not be possible, but which in any case is not germane for present purposes because it constitutes a mere change in form of reserves, rather than use of them); and second, they are subject to no formal repayment obligations.

In a general way, the concept of "owned" reserves has come increasingly to the fore as some of the people studying these matters have come to believe that if national governments and monetary authorities are to frame and manage their economic policies with confidence--and belief in the importance of their doing so is probably the dominant reason for the intensity of contemporary public interest in the whole subject of international liquidity--the reserves available to them for the support of such policies must be largely owned by them. However, the main reason for French interest in the owned-reserve concept is of a rather different sort. A fundamental point in French thinking is the view that the reserve-currency system is asymmetrical, in that it allegedly provides the reserve-currency countries with something approaching an open-end credit line, while requiring other countries to live within the limits of their owned reserves plus relatively fixed amounts of credit. Very baldly, they think the only practical way to end this asymmetry is to eliminate the reserve-currency system: not immediately, but ultimately. If this system were to be eliminated, something would have to be put in its place. Besides eliminating the alleged asymmetry in availabilities for the financing of deficits, the new system should--in the present French view--exert strong pressure on deficit countries to equilibrate their balance-of-payments positions as soon as possible. As they see it, a system of owned reserves like the one they propose would achieve both these objectives.

In opposition to French arguments in favor of basing the international liquidity system of the future largely on a system of owned reserves, the United States has urged that emphasis be placed instead on further development of international credit arrangements. A strong case can be made in favor of this approach.

For one thing, international credit facilities are clearly a necessity to monetary authorities, and to an efficient and rational international payments system, even if a scheme for deliberate reserve creation were to form part of that system. The reason is that the legitimate external financing needs of any country may at times outrun the external financing available to it in the form of owned reserves. In advance of actual experience, no country--at least no country which is reasonably open to external inflows and outflows on both trade and capital account--can ever know for certain the maximum balance-of-payments deficit it might incur during the period it might take for appropriate policies to restore equilibrium, and therefore its maximum possible need for external means of settlement during such a period. And if no country can know this, neither could the managers of an international system of reserve creation; so even the reserves created under such a system might, in given situations, be inadequate to the needs.7/

Moreover, in the economic interest of the world at large, as well as of the countries directly concerned, payments imbalances should be neither excessively large nor of excessive duration. If individual countries held owned reserves which were sufficiently massive to finance substantial external deficits for long periods, for a long while at least it might be difficult for other countries separately or collectively to exert pressure on such countries for corrective action. On the other hand, international credit--beyond some point, at least--is available only on a conditional basis. Conditioning the availability of credit upon specific approval at the time by the lending countries or institutions

7/ Unless they were created on a scale so massive as to exceed any possible needs. But reserve creation would always have to be limited, because otherwise there would be a danger of insufficient constraint on inflationary policies likely to lead not only to economic distortions within the countries following such policies, but also to disturbances of international trade and capital movements and to strains on the international payments system.

concerned provides useful opportunities for multilateral review and appraisal, which usually lead to a better understanding of the nature of the corrective action which should be taken: sometimes by surplus countries as well as by the country or countries in deficit. In some cases, the availability of the credits may actually be conditioned upon the adoption of particular policies, although understandings of this kind are usually tacit rather than explicit.

Finally, proposals featuring expansion in owned reserves rather than in credit facilities seem rather anachronistic in an era of tremendous development of credit systems. In the international monetary field in particular, it would seem reasonable to suppose that growing international economic cooperation would manifest itself in part by increased reliance on international credit, relative to reliance on owned reserves.

We now come to the second issue, which is closely related to the first. If a new system of reserve creation were agreed to be necessary, should it be the CRU plan as proposed by the French, or something else?

While the United States has not been enamored of the CRU idea from any point of view, its opposition has been based less on innate characteristics of the idea itself than on the form in which the French have put it forward. The United States has objected mainly on the following grounds.

1. The French have proposed to establish the CRU system within the Group of Ten, or in some such limited grouping. The U.S. strongly believes that if any arrangements for liquidity creation are needed, they should be set up in a wider multilateral framework, such as the IMF.

Since countries participating in a CRU plan would realize reserve gains by allocation--in other words, as a result merely of being participants--membership would be likely to be widely desired. Establishment of the plan outside the IMF, on an exclusive and quite arbitrary basis, could therefore engender strong resentment among the countries left out.

2. As already indicated, the French plan calls for a fixed link not only between CRU's and gold in settlements, but also the allocation of CRU's on the basis of relative holdings of gold. Comparative gold holdings are not a very satisfactory index of comparative needs for additional reserves. Moreover, allocation on this basis would constitute a new incentive for conversion of reserve-currency balances into gold. It can also be argued that allocation of CRU's on the basis of comparative gold holdings would really amount, in substance, to a disguised increase in the price of gold in transactions among member countries of the CRU system.

3. Under the unanimity rule thus far urged by the French, it might prove extremely difficult to bring about necessary increases in the supply of CRU's. One of the main objects of a CRU system, supposedly, is to find a way around the shortage of international reserves that could develop when the U.S. balance-of-payments deficit is ended. Not much would have been gained by moving to a system in which further expansion of reserves would be as difficult, or nearly so, as it is now feared it might become if no plan for reserve creation has been adopted by that time.

4. It is possible that foreign holdings of the reserve currencies--which above everything else means foreign holdings of dollars--would decline as the CRU system grew. Official dollar holdings by other

countries participating in the plan would almost certainly decline (particularly, as already noted, if CRU's were allocated on the basis of comparative gold holdings), and those of non-participating countries might decline. If aggregate foreign official dollar holdings declined more rapidly than CRU's were created, the CRU system would have caused a net decline in international reserves--the exact opposite of one of its main objectives.

According to U.S. thinking thus far, if new methods for owned-reserve creation are needed it would be preferable to establish them within the framework of existing international monetary arrangements--specifically within the framework of the IMF. Under existing IMF procedures, something tantamount to owned-reserve creation takes place even now, as a by-product of certain kinds of IMF transactions. Drawings of the currency of any member country by other member countries reduce the Fund's holdings of the currency drawn, and usually result in an equivalent increase in the gold tranche of the country whose currency is drawn. In many cases, such drawings put this country into what is known unofficially as the "super" gold tranche: a position in which the Fund holds in the member's currency less than 75 per cent of its quota. A member in this position can of course draw any amount of its total gold tranche practically automatically (since any gold-tranche drawing is practically automatic). But in addition, up to the point at which the Fund's holdings of its currency reach the 75 per cent level, such drawings are subject to no repayment obligation whatever.

Surely this constitutes an owned reserve in the meaningful sense of the term. Such a facility can be helpful to a member country even without a drawing by it, if other countries repay previous drawings of its currency to the Fund. The Fund system has been helpful to the United

States in this way, by absorbing $1.3 billion dollars in repayments in 1961 and 1963.

There are other ways in which reserves might be created in or through the IMF. It is true that the CRU itself could be set up within the IMF; but there are also other possibilities. One would be for countries to pay some part of their gold subscription to IMF in the form of gold certificates. This and some other possibilities, which I do not have time to explore in detail, are mentioned in Chapter 4 of the Fund's Annual Report. Some raise more questions than others. The further any plan gets away from reserve creation of the sort that occurs automatically in connection with existing types of IMF transactions, and goes in for deliberate additions to reserves without any necessary reference to current transactions, the more basic the questions it gives rise to, and the more searchingly they will need to be studied. Nevertheless the U.S. view is that <u>if</u> additional instruments of reserve creation are needed, it would be both possible and preferable to establish them within the framework of the familiar: that is, of the International Monetary Fund.

The third issue raised by the CRU plan is whether the reserve-currency system should be retained, and, if so, whether a CRU system would be likely to permit this.

In putting forward his initial CRU proposal, E. M. Bernstein clearly assumed that reserve-currency holdings would continue to co-exist with CRU balances. The French have stated, however, that although in their view continuation of the reserve-currency system would be consistent with operation of a CRU plan, their intention is to replace it. Whether the two could co-exist for very long is debatable. In any event, it could be argued that if a CRU system were adopted it <u>should</u> lead to the demise of the reserve-currency system. For one purpose of a CRU plan would be to eliminate the instability which many people now believe to be inherent in the reserve currency system. To the extent that this system is retained, its instability potential will presumably also remain.

In theory, the case against the reserve-currency system is strong. But aside from the fact that this system has some important advantages, it is deeply embedded in the international monetary system; and to replace it with something else without damaging the international monetary and trading system itself might not be easy. One point in particular to which those who advocate abolishing the reserve-currency system seem to have given insufficient thought is the problem of private balances. Even if foreign countries ceased holding official balances in reserve currencies (and it is improbable that all of them would do so), private parties presumably would remain free to hold balances in these currencies, and would continue to find advantages in doing so. Such balances would be likely to continue to grow over time. Thus the countries of issue of these currencies would remain vulnerable to sudden flights by these private foreign holders, who would be likely to be much more jittery than most central banks are today; and under a system which prohibited official holdings of dollars and sterling (as a CRU system might, ultimately), such flights would not be at least partly cushioned, as they are today, by increased central-bank holdings.

To say that in a world of convertibility, domestic as well as foreign holders of a currency may become jittery--which of course is perfectly true--is no answer; it merely means that the problem is even worse than might at first appear. The point is that large-scale foreign holdings of a particular currency are an element of vulnerability to capital flight which is <u>additional</u> to the vulnerability of any convertible currency implicit in the possibility of flight by <u>domestic</u> holders. Moreover, foreign-held balances in a currency are likely to be more volatile than balances held by residents, because in many cases, at least, foreign holders are more in the habit of actually moving their funds or of contemplating doing so.

Essentially, then, the question here is whether as a practical matter the reserve-currency countries, especially the United States, <u>could</u> escape the extra vulnerability to capital flight that large foreign holdings of their currencies creates--since large foreign holdings would presumably continue even under a CRU system, if only in private hands.

The broad U.S. view regarding the reserve-currency system is that while it confers certain advantages on the United States, it also entails burdens; and the main reason why the United States wishes to see it continue is not its direct benefit to us, but rather the belief that on balance it is definitely an asset to the international monetary system. On this view, reform proposals should build <u>on</u> the existing system, not attempt to replace it altogether, or experiment with schemes which might unintentionally have the same effect.

The fourth issue posed by the French proposal is what the role of bilateral credit accommodation should be in the future. One of the French aims in proposing the CRU is to force deficit countries into more rapid reestablishment of external equilibrium by limiting the external financing available to them. To succeed in that aim, any plan for providing needed international liquidity primarily through a system of reserve creation would have to limit recourse to other financing availabilities, especially credit. In other words, the CRU plan contemplated by the French would almost certainly try to limit access to increases in bilateral credit facilities, through a system of multilateral control or supervision, in place of the milder system of "multilateral surveillance."

This issue has obvious links with the question of the reserve-currency function. The position of the reserve-currency countries on this point is that as long as they have special responsibilities for the stability of the international payments system, they cannot be put into a financial strait jacket, but must retain some freedom of action through bilateral channels. Indeed, most countries try to take advantage of their bilateral bargaining power when the need arises, and it would be unrealistic to assume that the United States would ever lightly relinquish its own possibilities of this kind.

A fifth issue raised by the CRU plan is how much emphasis should be placed in future on rapidity of balance-of-payments adjustment. We have seen that one basic aim of the restrictionist approach of some European countries to the question of future expansion of international reserves or credit facilities is to exert increased pressure on deficit countries to follow policies designed to restore external equilibrium promptly. On this point, French and Dutch sentiment is currently reinforced very strongly by that of some Germans, who have recently been insisting that external equilibrium must have an overriding policy priority, just as in the era of the gold standard.

In the past, balance-of-payments deficits have typically been associated with inflationary conditions internally. Both conditions normally called for the same type of corrective policies--namely, policies of restraint. And among the advanced countries, at least, strong pressures for corrective action usually are present internally as well as externally. In these cases, need and inclination meet on common ground, and correction is usually fairly prompt.

The problem we are faced with today is the very different problem of the "hard case": external deficit and internal under-utilization of resources (and on the other side, external surplus and over-full employment internally). In such cases, as we in the United States now know all too well, the requirements of internal policy may be in short-run conflict with external policy requirements. In the case of the country in external deficit, rapid elimination of external deficits may be possible only at the expense of strong domestic deflation. In such cases it is natural for the deficit country to argue that less damage will be done to its level of activity, and hence--if it is a large country--to world production and trade, if it is permitted to effect the adjustment gradually over time, with the help of external assistance in financing its balance-of-payments deficit while it continues. It is also natural for the deficit country to point out that there are some types of action that surplus countries can take which would help to restore both external and internal equilibrium: notably, steps to liberalize the inflow of goods or the outflow of capital. Action along such lines could help not only to moderate both the internal inflationary pressure and the balance-of-payments surplus of the surplus countries, but also the deficiency of demand and the balance-of-payments deficit of the deficit country.

To the first of these arguments (namely that financing should be provided to permit cushioning of adjustment, by spreading it out over time) the surplus countries reply that the more external financial assistance is provided to the "hard-case" deficit country, and the easier the terms, the greater will be the tendency of that country consciously or unconsciously to use such assistance to postpone corrective action, rather than to provide time for action. To the second argument (that corrective action can be taken in the surplus countries, to the benefit of both surplus and deficit countries), the surplus countries reply that corrective action by them--for example, through lowering tariffs--is not all that easy. And theoretically, at least, in some cases there may be very little room for further liberalization of import controls or of capital export controls. Moreover, the development of efficient capital markets that could channel more savings to capital-short countries is bound to take a great deal of time. Also, the surplus countries tend to react against what they construe as a suggestion that they have little or no independent option in economic policy: that they must adapt to the consequences of whatever policies the deficit country may be following.

The question of the comparative responsibilities of surplus and of deficit countries was a hotly-debated issue in Europe in the early 1950's, when the situations of each, in their typical manifestations within Europe at that time, were usually the classical ones characterized by lack of conflict between the needs of internal and of external policy. It may therefore be understandable why this question is, if anything, even more difficult today. As I indicated earlier, the whole question of balance-of-payments adjustment under contemporary conditions is now widely recognized as one of the key problems in the international liquidity field, and it is to be studied intensively by Working Party No. 3 of the OECD.

The five issues I have discussed are clearly among the more difficult unsettled issues concerning international liquidity. The main thought I should like to leave with you is that in the international monetary field, just as in some major areas of international political and military relations, we are faced with one of the major dilemmas of our time: the problem of how to manage without centralized control--in other words, with multiple sovereignties--an international financial system in which there is a high degree of interdependence among nations. Perhaps my remarks will have made clear some of the problems posed by a dilemma of this sort. Part of our difficulty is that in many cases it is not so much a question of finding "the" right answer, distinct from all other answers assumed to be wrong. In connection with some world political problems it has been said that it seems to be a characteristic of our age that there are grave objections to all alternative courses of action; and this may also be true of the international monetary field. In both cases, the problem is to find the combination of answers acceptable to sovereign countries which gives the best results.