ESSAYS IN INTERNATIONAL FINANCE

No. 39, September 1962

RECENT TRENDS IN INTERNATIONAL MONETARY POLICIES

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This is the thirty-ninth number in the series ESSAYS IN INTERNATIONAL FINANCE *published from time to time by the International Finance Section of the Department of Economics in Princeton University.*

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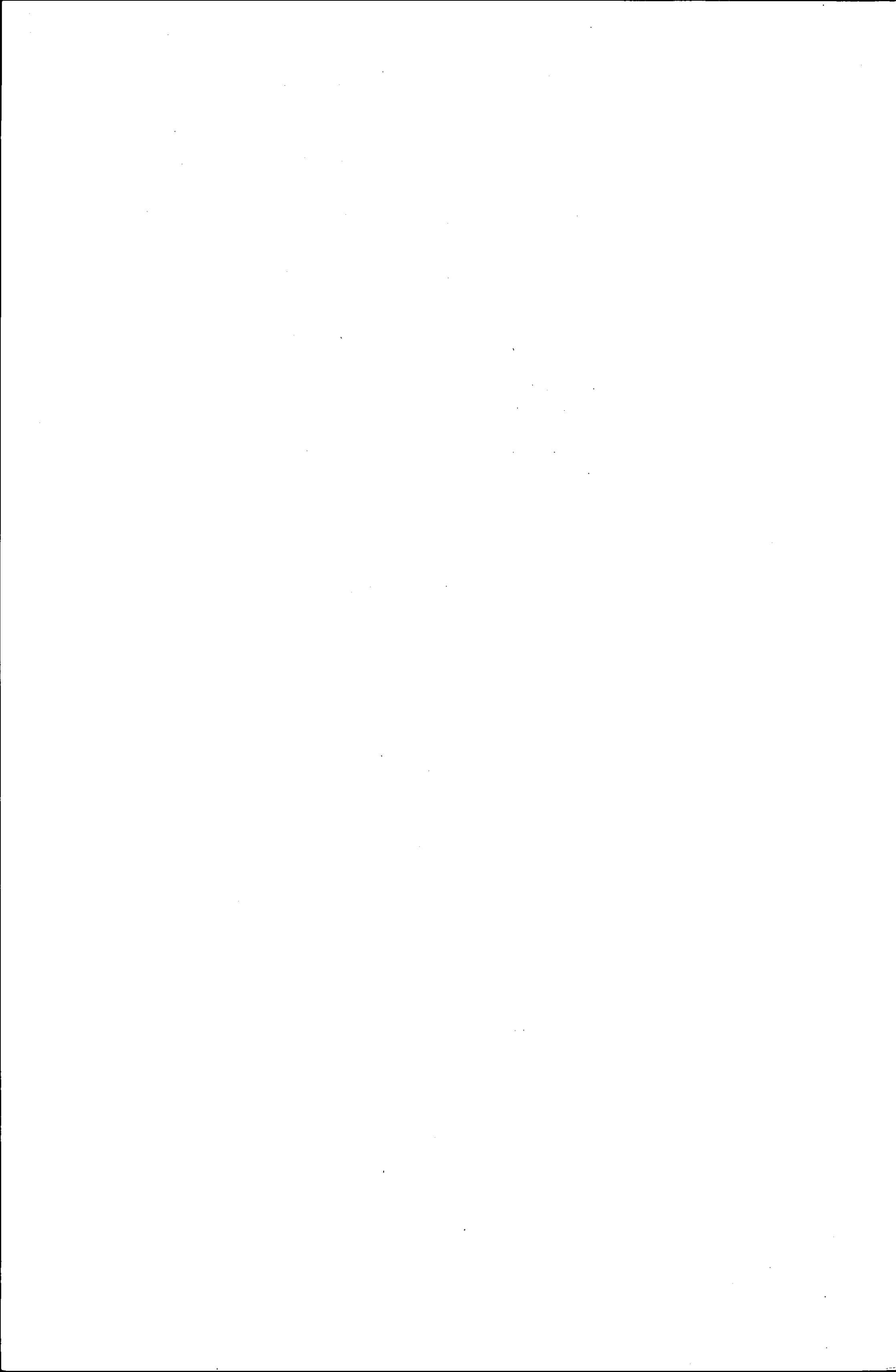

RECENT TRENDS IN INTERNATIONAL MONETARY POLICIES

TWENTY-FIVE years ago last September, France, Switzerland and the Netherlands gave up their loyalty to the international gold standard, of which they had been the last European standard-bearers. In fact, five years earlier, in 1931, the free exchangeability of sterling against gold at a fixed par value had been abolished, and thereby the system had already been reduced to a ghost.

During the 20's and even more in the course of the 30's, a lively discussion among economists took place about the merits of the gold standard system and its feasibility under the then prevailing conditions. At first the question was raised whether the existing gold supply did not constitute too narrow a basis for the support of a sufficient fiduciary money circulation. Was there a scarcity of gold? Later, under the influence of the great depression, the discussion concentrated on whether there was an inescapable conflict between the requirements of maintaining stable international exchange relations on the one hand and monetary policies conducive to internal price stability and national prosperity on the other. Were the rules of the game of the international gold standard still nationally acceptable?

With the fall of the gold standard these questions seemed to have lost their practical significance. There followed a period of economic nationalism, extended through and intensified by the Second World War. Under the slogan of "a New Freedom" the stability of international exchange rates was sacrificed—albeit tempered by the creation and operation in a number of countries of Exchange Equalization Funds—and monetary policy was primarily directed towards the mobilization of national productive resources, first for peaceful purposes (the recovery from the depression), later for war preparations, and finally for the actual war effort. International trade and payments relations were given a stepchild treatment or cynically disrupted.

When the war was over, this dark period of economic nationalism came to an end, but it left a legacy of strict controls over the international flow of gold, goods and capital, and a system of severely restricted international payments. These conditions facilitated, or at least allowed, monetary policies to be governed by internal considerations to a much larger extent than would have been possible under a system of free international trade and payments.

The institution of the International Monetary Fund (I.M.F.) early in 1946, with its requirements that members should establish for their currencies par values expressed in gold or U.S. dollars and maintain these par values as much as possible, meant a big step forward towards the reconstruction of a system of stable international currency relations. The Fund, however, tolerated for a so-called transitional period the continuation of payments restrictions and the inconvertibility of currencies. During that period, which covered most of the 50's, the U.S. dollar reinforced its position as the world-standard-currency. Meanwhile, the deficit on the U.S. balance of payments, which accumulated almost year by year, not only made for a better international distribution of the world stock of gold but also increased considerably the amount of dollar-holdings by foreign countries, thereby adding to the total amount of international-payments reserves.

By the end of 1958 a new period had started. After a long and gradual process of liberalization of their trade and payments policies, and with booming economies, the main Western European countries established the external convertibility of their currencies. A year later, after the devaluation of the French franc, they assumed the full obligations of their membership in the I.M.F. Although these obligations did not include freedom of capital transfers, in fact capital transactions too were largely liberalized. At the same time, however, the U.S. balance-of-payments deficit reached an exceptionally high figure and in a few European countries holdings of dollar balances piled up. This gave rise to doubt in certain quarters about the stability of existing exchange rates. For this and other reasons short-term capital went on the move from one international centre to another. Foreign-exchange markets became unpredictable.

Under these circumstances, the two questions which thirty years ago were so much discussed jumped again into actuality. Is there a shortage of monetary reserves? Does there exist, in a world free of trade and payments restrictions, an inescapable conflict between a monetary policy aiming at external stability and one directed towards maintaining domestic equilibrium? In the 30's the disruption of the international monetary system caused these questions to be silenced by a disastrous flood of economic and monetary nationalism. Today, everybody is convinced that a similar disaster has to be prevented and that, inasmuch as these questions are realistic ones, every effort has to be made to find constructive solutions for them; if need be, in international cooperation. In fact various schemes are already being elaborated and monetary policies are being reconsidered to meet the new challenge which the free world has to face in this strategic field of the continuous

battle for national and international prosperity. Let me say something more on these issues.

The adequacy of monetary reserves

In the 20's and 30's, a period of general decline of price levels and of recurrent deep and long-lasting depressions, the opinion was widely held that the scarcity of gold was a major cause of deflation. This was due to the fact that in many countries, either by law or by convention, the money-creating institutions had to maintain a reserve-ratio, related either directly or indirectly to the available amount of monetary gold. Under the then prevailing system, national liquidity, i.e. the domestic volume of money, as determined by national gold reserves, was the main preoccupation. Here, an important evolution has taken place. In an increasing number of countries gold-cover requirements for the fiduciary circulation have been abolished. Even in the United States the question is raised: what is the real advantage of the still existing 25-per cent gold-reserve requirement of the Federal Reserve? Authoritative voices say: none. The final emancipation of money creation from the remnants of metalism seems to me only a matter of time. In the present discussion about the liquidity problem, the sufficiency of gold reserves relative to the required or desired domestic volume of money is no longer an issue. Liquidity in connection with gold has become an international concept. The adequacy of gold and other international payment reserves relative to the volume of world trade or world payments is now considered to be the crucial question. Professor Robert Triffin's thesis about the future of the dollar is entirely based on this ratio. "The test of the adequacy of international monetary reserves," stated Mr. Edward Bernstein last year before the Subcommittee on International Exchange and Payments of the Congress of the United States, "is whether they are sufficient to meet cyclical and fortuitous fluctuations in international payments without undesirable restrictions on world trade. . . . The purpose of reserves is to give countries time to restore their balance of payments . . . . ." Liquidity in the domestic sense, on the other hand, has not lost its significance; it can best be expressed, however, not in terms of gold holdings, but in terms of the general level of prices or of unit production costs.

According to the usual concept, international liquidity or international monetary reserves include the gold holdings of official institutions (central banks, treasuries and equalization funds) as well as their holdings of foreign convertible currencies (U.S. dollars, sterling and other convertible foreign exchange). Holdings of foreign exchange by commercial banks are not regarded as part of official reserves, even though

it is possible for the monetary authorities to acquire such balances in case of need. The resources of the I.M.F. in gold and convertible currencies can be regarded as part of the international monetary reserves in so far as the Fund is prepared to make them immediately available to its members.

It is generally agreed that during the last twenty years the volume of international liquidity thus defined has shown a very substantial increase. Besides a further accumulation of monetary gold, the most important contributions have been the large accumulation of foreign holdings of sterling in the 40's and the very considerable increase of foreign holdings of U.S. dollars in the 1950's. During the last decade, the rate of growth of aggregate official international reserves, outside the Soviet bloc, was, according to the best available information, between 2½ and 3 per cent per annum. By the end of 1960 they had reached the figure of about $60 billion, apart from the resources of the Fund. I do not know of any reputed economist who contends that the present stock of international monetary reserves is inadequate, with the outstanding exception of Sir Roy Harrod. Even Professor Triffin stated about a year ago: "I, too, feel that the volume of international liquidity . . . may have increased too rapidly, rather than too slowly, in recent years." And I quote once more from Mr. Bernstein: "There is no evident shortage of international monetary reserves, certainly not if allowance is made for the availability of the resources of the International Monetary Fund." This, too, was the conclusion reached by Dr. Holtrop, the President of the Nederlandsche Bank, in his much quoted speech last September in Vienna.

Nevertheless two problems remain. First, a long-term problem: whether in the future the increase of international liquidity will continue to be adequate to match the greater needs of the free-world economy. Second, a short-term problem: whether the two major reserve currencies, the U.S. dollar and sterling, are strong enough and can be sufficiently defended to inspire confidence that they are as good as gold —a confidence on which their reserve position depends.

As far as the long-term problem is concerned, there is little if any doubt that, unless there is a change in the price of gold, or unless gold exports from behind the Iron Curtain substantially increase, the increase of the monetary gold supply will be definitely inadequate to meet the future needs of the world outside the Soviet bloc. Over the last ten years, the increase in the holdings of monetary gold by all countries and international institutions, excluding the Soviet bloc, has been about $6 billion, i.e., just about one third of the increase of total monetary reserves. The other two thirds were made up of an increase in foreign

holdings of convertible currencies, mainly U.S. dollar balances resulting from the U.S. balance-of-payments deficit. Between the beginning of 1950 and the end of 1960 this deficit amounted to not less than $19 billion, of which $6 billion was settled by the export of gold (constituting a redistribution of existing reserves) and the remainder by the creation of short-term dollar obligations (dollar balances, if looked at from the other side), partly held by official institutions, partly in private hands. By the end of 1960 the total amount of U.S. short-term dollar obligations had accumulated to $20.4 billion, almost equally divided between foreign official and foreign private holdings. Against this there figured a remaining U.S. gold reserve of $17.8 billion, $12 billion of which was (and still is) earmarked as cover for outstanding notes and deposits of the Federal Reserve, leaving a free margin of almost $6 billion. At the end of 1960 the short-term overseas sterling obligations of the U.K. amounted to $10.9 billion, of which $4 billion was held outside the sterling area. Over the last ten years, foreign-held sterling balances have not increased at all, and foreign-held balances in other convertible currencies have increased by no more than the equivalent of a few billion dollars. These figures clearly illustrate how greatly dependent the free world has become for its supply of adequate international monetary reserves on the creation of dollar balances, i.e., on a U.S. balance-of-payments deficit.

The gold cover of the official dollar balances is still ample, at least if one includes the $12 billion of the gold-reserve requirement. If, however, one takes into account the dollar balances in private hands, the gold cover of the total U.S. short-term indebtedness is already less than 100 per cent. It is very dubious whether the United States can afford to continue running balance-of-payments deficits of an order of magnitude comparable to that of the last ten years. And it is equally dubious whether other countries would be prepared to accumulate further dollar holdings only partly covered by gold. Even today, massive withdrawals of dollar balances for conversion into gold would quickly deplete the U.S. gold stock and impair the position of the U.S. dollar as a reserve currency. It is not surprising, therefore, that it has already been suggested that attempts should be made to work out some sort of arrangement between the European central banks and the Federal Reserve to the effect that dollar balances will not be converted into gold without limit; but this raises the difficult point of a gold guarantee to be attached to official dollar holdings.

Since a further significant increase of foreign-held dollar balances has become questionable, thought has been given to the problem of finding other ways and means by which the volume of international

liquidity might be kept adequate in relation to growing world needs. The possibility has been suggested that new reserve centres will emerge, whose currencies will be held as reserves with the same assurance as dollars and sterling. But international exchange reserves are created as a result of a strong and reliable country having a balance-of-payments deficit which is settled by short-term credit; and one wonders which other country or countries could perform this function on an appreciable scale. Therefore, it seems to me that great importance should be attached to the various proposals for developing new sources of international liquidity by international cooperation which have been presented in recent years: the Triffin Plan, the Stamp Plan, the Bernstein Plan and the proposals of the Radcliffe Committee.

These proposals have in common that an international institution, preferably the International Monetary Fund, should be empowered and authorized, in case of need, to create supplementary international liquidity; but they differ in basic respects. I do not intend to embark on a discussion of the specific characteristics and merits of these proposals, but would like to state that, although the existing volume of international reserves probably leaves a margin for a limited number of years, the problem dealt with by the proposals which I have mentioned is, in my opinion, a very real one. It is true that other, very different suggestions have been made for the solution of the long-term problem discussed here, as for instance the proposal for an upward revaluation of the price of gold, or the introduction of flexible exchange rates; but these solutions appear to me to be definitely undesirable.

The arguments against gold revaluation are powerful enough to discard this solution as unpractical. I only mention the most significant ones. First an increase in the dollar price of gold would bring windfall profits to the gold-producing countries, of which South Africa and Russia, followed by Canada, are the most important, and to those with the largest gold reserves, among which Russia stands second, next to the United States.* Thus, the direct benefits would be very unevenly distributed, and in a way to which the United States and many other countries should have great and well-founded objections. Second, a gold revaluation operation deliberately performed to meet the world liquidity requirements and not forced upon the United States as the outcome of a prolonged or acute economic or financial crisis, would shake the confidence in all currency reserves, particularly those in U.S. dollars and sterling, and cause a speculative scramble for gold, in the

* The USSR gold holdings are estimated at possibly $7 billion or more, and the USSR gold production in 1957 at about $600 million, nearly equal to that of South Africa, and four times as large as that of the next largest gold-producing country, Canada.

expectation of a repetition, sooner or later. Third, each revaluation of gold would result in a temporary excess of world liquidity, due to its impact upon the valuation of existing gold reserves at the time; moreover, any such action would have to take care not only of the immediate needs, but also of the needs of a certain period in the future and, therefore, again would tend to be at first excessive. For these reasons alone I consider this solution both undesirable and dangerous.

The introduction of a system of flexible exchange rates would run counter to the basic philosophy of the International Monetary Fund which was created as a permanent mechanism to promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation. These objectives were adopted in consideration of the historical record of exchange-rate flexibility, as applied after the first world war by countries which did not maintain an appropriate balance in their internal monetary and credit policies. It is noteworthy that, in most of these cases, the end of the story was either a complete currency collapse—as in Germany and Central Europe—or a driving down of exchange rates to levels which considerably undervalued the currency in question—as in France and Belgium. This historical argument should perhaps not be considered as conclusive, in view of the quite abnormal strains to which the world economy was subjected in the 20's and 30's, and the mismanagement of fiscal and credit policies which then prevailed, particularly in Europe.

The case against flexible rates, however, has stronger foundations in the conditions which such a system would, by its very nature, create for international trade and credit transactions and for maintaining internal financial discipline. A full discussion of this object cannot be undertaken here; I must restrict myself to a summary of the arguments. First, flexible exchange rates increase the financial risks of international traders, borrowers and lenders, and are generally considered as harmful —or at least troublesome—by the business community interested in world trade and foreign investments. Second, corrections of temporary balance-of-payments disequilibria by exchange-rate appreciations or depreciations invite and stimulate speculation which could easily amplify the initial rate fluctuations and cause disturbances necessitating various kinds of direct intervention. Third, as far as the underlying causes of balance-of-payments disequilibria consist of unsound fiscal and credit policies or cost pressures which should be resisted, automatic exchange-rate adjustments do nothing to remedy what is fundamentally wrong, but rather tend to perpetuate the unhealthy conditions.

I may perhaps add one qualification to this indictment of flexible rates. It has been the experience of the International Monetary Fund