The Question of International Liquidity at the Fund Meeting

The question of international liquidity was the main theme of this year's annual meeting of the International Monetary Fund held in Washington during the week beginning September 30. The general consensus of the participants was that liquidity is at present adequate to satisfy the needs of the world economy, and is likely to remain so in the immediate future. However, lest the growth of world economic activity be hampered by a possible liquidity shortage at some future date, it was thought useful to study ways in which the international financial system could be further improved and strengthened. A series of actions to reinforce the international payments mechanism through cooperative measures has, of course, been taken over the last few years. Furthermore, the mechanism has been under constant study and review by a number of official bodies, including the IMF, the central bankers who meet regularly at the Bank for International Settlements in Basle, Working Party 3 of the Economic Policy Committee of the Organization for Economic Cooperation and Development (OECD) in Paris (which deals particularly with financial policies of member countries), and national treasuries and central banks. Two new studies, however, will now be undertaken on a somewhat more formal basis.

A comprehensive study of the future of the international payments system will be undertaken by the so-called Group of Ten—a group of ten countries whose combined international reserves account for 80 per cent of the world total. These countries have been associated since 1961 under the General Agreements to Borrow, which are designed to augment the IMF's resources in case of need.[1] The IMF—whose broad membership (102 countries) and wealth of experience make it a center of the international financial world—will also be conducting an examination of the subject, with a special report on the potential contributions of the IMF. The Fund's analyses will be utilized by the Group of Ten as their comprehensive study proceeds.

World liquidity, as understood in this context, refers to the generally accepted official means of settling imbalances in international payments. Thus, it comprises the gold and foreign exchange holdings of monetary authorities, plus such additional means of payment as may be available to them through international and bilateral credit facilities. An appropriate level and distribution of world liquidity are essential to the attainment of a continuous and stable expansion of world trade and investment, which is in turn a major stimulus to world-wide economic growth. In this respect, the present international financial system has performed very satisfactorily. International reserves, including credit facilities, have proved adequate to meet the difficult problems posed by an unprecedented expansion of world trade and by large shifts in the direction and structure of trade, and to meet the equally difficult problems arising from very substantial increases in the movement of short-term and long-term capital across national frontiers. In the recent past international liquidity has been bolstered, and its effectiveness increased, by cooperation among the central banks and treasuries of the major industrial nations and by an enlargement of the resources, and greater use of the facilities, of the IMF. These developments have included the resumption of United States intervention in the exchange markets, the development and rapid expansion of inter-central-bank credit facilities, and the issuance by the United States Treasury of certificates and bonds denominated in foreign currencies. The IMF, strengthened by a general increase in quotas in 1959 as well as by the 1961 Paris agreement, has expanded its activities in support of the major currencies, including the provision of large stabilization credits to the United Kingdom in 1961 and to Canada in 1962. In July 1963, the United States also entered into a stand-by agreement with the Fund.

As a result of these arrangements, the international monetary system has been able to absorb both the strain of persistent heavy imbalances in payments among major countries—including especially the United States deficits since 1958—and the successive shocks of such events as

[1] These agreements—concluded in Paris in December 1961, ratified by the United States Congress in June 1962, and effective since October 1962—established a network of facilities under which the IMF can borrow up to $6 billion equivalent of group-member currencies. The group consists of Belgium, Canada, France, West Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom, and the United States. For background of the agreements, see "The Vienna Meeting of the Internationl Monetary Fund", this *Review*, October 1961, pp. 167-69.

the revaluation of the German mark and the Dutch guilder in March 1961, the Berlin crisis in the fall of 1961, the attack on the Canadian dollar prior to and following the re-establishment of a fixed par value for that currency in May 1962, the Cuban crisis in the fall of 1962, and the rejection of the British application for membership in the Common Market early this year. The evolution of the present international monetary system and its capacity to cope with crises were reviewed by four central bankers in a recent issue of this *Review*.[2]

In dealing with the financing of future swings in payments accounts, the central bankers noted that they saw no effective alternative to reliance upon a further development of mutual credit facilities among the major trading nations. At the same time, however, the central bankers emphasized that even strong currency defenses cannot be a substitute for the eventual correction of major underlying payments imbalances—a point heavily stressed at the IMF meetings as well. In this respect, the continued balance-of-payments deficits of the United States have been a source of concern. The delegates at the IMF meeting noted the efforts undertaken by the United States to re-establish balance in its foreign accounts, and also the reaffirmation by both President Kennedy and Secretary of the Treasury Dillon that the United States does not regard a possible enlargement of the methods of providing world liquidity as relieving this country of the task of solving its payments deficit. In fact, one of the important reasons for studying future world liquidity needs is the prospect of an improvement in the United States balance of payments. President Kennedy underlined this point graphically in his address to the Fund, when he said: "We recognize that the reserve position of other countries is a mirror image of our own—and that as the United States moves toward equilibrium, it will be more difficult for others to increase their reserves."

The Fund's inquiry will be conducted by its staff, and it is hoped that some conclusions may have emerged by the time of next year's annual meeting in Tokyo. In speaking of its aims, Pierre-Paul Schweitzer, the Fund's new Managing Director, said in his address to the meeting:

> In my view the members of the Fund, taken as a whole, are not at present being prevented from adopting or carrying out desirable policies by any shortage of international liquidity. But it is wise and prudent to look into the future to consider what difficulties might arise and to devise ways of meeting them. This has been the habit of the Fund. All the main developments in the policies and practices of the Fund . . . have been preceded by long periods of study which have laid the foundation for positive action. In the coming year the Fund will develop and intensify its studies regarding international liquidity, the functioning of the international monetary system, and the effective role of the Fund in this field.

This initiative of the Fund was widely endorsed by the participants at the meeting. Among them, Governor Holtrop of the Netherlands Bank expressed his approval and pointed to an important reason for such a study:

> International liquidity has of late become so much of a subject of public controversy, upon which such a variety of highly contradictory opinions are being held and propagated, that one often is reminded of the saying that "money has made even more people mad than love". Under these circumstances there is great need for authoritative answers to a great number of questions. I am happy that a body like the Fund will give concentrated attention to this subject.

At the same time, Mr. Schweitzer stated in his address that "there is a wholly understandable interest in this important range of problems which extends beyond the Fund" and hence "other bodies, groups of countries, and individual members will be engaged on similar inquiries".

The study conducted by representatives of the Group of Ten will be a broad-ranging one. These representatives, who intend to cooperate closely with the Fund, will include high-ranking officials from the ten countries, with United States Under Secretary of the Treasury Robert V. Roosa acting as chairman and Emile van Lennep, Treasurer General of the Netherlands Finance Ministry, as vice chairman. The results of their investigation will be reported to the ministers and central bank governors of the Ten. The study is to encompass "a thorough examination of the outlook for the functioning of the international monetary system and its probable future needs for liquidity". It will also evaluate various alternatives for covering such needs. Two possible courses were ruled out explicitly: a change in the present price of gold and the adoption of a system of fluctuating exchange rates.

Individual countries, of course, have made it clear that inquiry into certain other matters—the transformation of

[2] See "Conversations on International Finance" by C. A. Coombs, M. Iklé, E. Ranalli, and J. Tüngeler, this *Review*, August 1963, pp. 114-21.

the IMF into a supranational central bank, for example—may not be especially fruitful. Another such matter is that of generalized "guarantees" of the gold value of the present official holdings of foreign currencies. In the view of the United States, such guarantees cannot provide any meaningful assurance. Instead, the real basis for confidence in a currency is to be found in the strength, performance, and stability of the issuing country's financial system.[3]

The discussion at the IMF meetings, on the other hand, did point to certain general areas of widespread interest for these studies. It was unanimously held, for example, that any study of the question of international liquidity should consider ways of strengthening incentives for individual countries to rectify imbalances in their international payments. To be sure, ample reserves must be readily available to finance temporary deficits, so that the flow of international trade and payments will not be disrupted. But as Reginald Maudling, the British Chancellor of the Exchequer, put it:

> . . . the availability of liquid resources should not be such as to promote, or encourage countries to tolerate, the continuance of basically unsound domestic or international positions in the guise of temporary fluctuations. The basic dilemma is clear. If adequate resources are not available automatically or nearly automatically, their usefulness in times of trouble may be problematic; but, to the extent to which they are automatically available, they may present a temptation to refrain from the necessary corrections of policy.

In fact, insufficient balance-of-payments discipline alone may create a shortage of liquidity by destroying confidence in currencies that supplement gold in official reserves. It is therefore important, in the words of Ludger Westrick, the German delegate, that

> any improvements that might be thought out for our international monetary system—and there is always room for improvements—should not be concentrated only on the question of how best to finance balance-of-payments deficits, but also on the even more important question of how to provide sufficient incentives for curing them.

In addition to such general areas, certain concrete questions relating to the composition of international liquidity were suggested for examination by some of the participants. What are the possibilities for international reserves to be held in currencies other than the dollar and sterling? What are the implications of the existing discrepancies in the ratio of gold to total reserves among the major countries? Changes are conceivable that would potentially increase total world liquidity and would also meet the criticism that the current system is not fully reciprocal in the sharing of currency risks between countries which hold uneven proportions of gold and foreign exchange. The last point was stressed by the French Finance Minister Valéry Giscard d'Estaing:

> Within the monetary system itself, certain countries maintain a policy of keeping their reserves in gold, and of holding foreign currency only to the minimum extent required by current transactions. Other countries, the list of which varies, hold large amounts of foreign currencies, at times as much as half their total reserves. This situation certainly does not reflect an equitable distribution of the burdens of international monetary cooperation.

Thus, a broad range of subjects will be reviewed by both the IMF and the Group of Ten. But, as Under Secretary Roosa pointed out shortly before this year's meeting, there is not any reason to assume "that daring or revolutionary approaches will in fact emerge for the future. The process of evolution may very well take us where we want to go."[4] In actual fact, of course, evolutionary changes of the type that have taken place over the last few years — including both the increase in the IMF quotas and the Paris agreement — already add up to major reforms of the international financial system. Similarly, the various cooperative arrangements concluded among the central banks and treasuries of the major industrial countries have been striking innovations, creating new sources of international liquidity. Furthermore, the distinct advantage of these cooperative measures has been that they did not necessitate either radical institutional changes or complex new operating mechanisms and have thus been capable of rapid implementation while also gaining widespread acceptance. The commanding questions now are whether, and how, these achievements in cooperation can be flexibly adapted to meet the needs in the years ahead.

[3] See Robert V. Roosa, "Assuring the Free World's Liquidity", Federal Reserve Bank of Philadelphia, *Business Review* (Supplement), September 1962.

[4] Robert V. Roosa, "Reforming the International Monetary System", *Foreign Affairs*, October 1963, p. 121.