For Release on Delivery

(Approximately 1:00 p.m.
Saturday, October 2, 1965)

THE LINKS BETWEEN

Remarks by Governor J. Dewey Daane

Member, Board of Governors of the Federal Reserve System

at the Luncheon Meeting of the

Georgetown University Bankers' Forum

Washington, D. C.

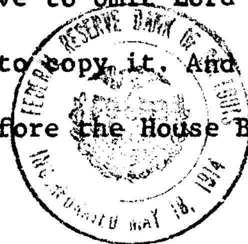
on Saturday, October 2, 1965

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Remarks by Governor J. Dewey Daane
Member, Board of Governors of the Federal Reserve System
at the Luncheon Meeting of the
Georgetown University Bankers' Forum
Washington, D. C. - Saturday, October 2, 1965

THE LINKS BETWEEN

As I understand it, Matt Szymczak originally had scheduled Lord Cromer, Governor of the Bank of England, for these luncheon remarks. Subsequently, as you all know, he turned to Attorney General Katzenbach so in effect today I am in the happy position of substituting for a substitute, which I hope leaves me considerable freedom of talk if not of thought. Whenever I am called on to substitute for someone on a program, I remember the time when I was a boy back in Michigan in the late 1920's and my father and mother took me to New York to the opening of a new Broadway musical entitled "Three Cheers", scheduled to star the famous acrobatic dancer Fred Stone and his two equally famous dancing daughters, Dorothy and Paula. Just two weeks before the opening of this musical, however, Fred Stone was hurt in a plane accident and his role was taken by his close personal friend Will Rogers. As the curtain went up on the play, Will came in twirling his rope, parked his gum on the side of the stage, and began by saying--"Fred Stone was supposed to start by jumping from this balcony--pointing to a balcony at the back of the stage--do a triple somersault, land on his feet between Dorothy and Paula, and break into a fast shoe shuffle. That part of the program will be omitted this evening." Well this noon I will have to omit Lord Cromer's accent for the simple reason I could not hope to copy it. And as those of you know who are aware of my testimony before the House Banking and Currency Subcommittee



LIBRARY

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

a few weeks ago, I might find it equally difficult to emulate Attorney General Katzenbach, or at least to copy his accent with respect to bank mergers. Instead, when we discussed my last minute appearance on this program and what I might say, Matt Szymczak suggested that I try to link the morning and afternoon discussions. The subject of links seemed appropriate for a Saturday discussion and I agreed to attempt to do so. So my seemingly ambiguous title is not as esoteric as it sounds.

As I have thought about the matter there seems to me to be at least one quite obvious link between them. This morning the general subject was "Gold and the Monetary Unit" and we were looking outward to the functioning of the world payments system and more specifically at the question of reserve creation and its impact and implications for both the developing and developed countries. This afternoon the distinguished speakers will be turning inward and looking more closely at developments and policies at home. But without pre-empting their remarks in any way, it is clear that neither monetary policy nor debt management in recent years has been oblivious of the world payments system, nor of the need for adjustment of imbalances in our balance of payments. Thus perhaps the first and most obvious link is what I would label the "Roosa categorical imperative", deriving from the Per Jacobsson lecture by Mr. Roosa of yesterday afternoon, namely, that on the one hand monetary policy has to be formulated with full regard for all other elements of public policies and objectives--and clearly this includes balance of payments considerations and international reserve

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

asset creation--while, on the other hand, other appropriate public policies cannot ignore the elements of monetary discipline essential to the system. As far as the implementation of this link in practice in terms of monetary policy decisions and debt management actions, I will leave discussion of that to the afternoon speakers. But I may add a bit of more to the remarks of the morning speakers--not in any way in rebuttal but more by way of amplification and perhaps clarification.

My first observation is that it is interesting to find that under the general topic of "Gold and the Monetary Unit" the three speakers this morning talked mainly about a payments system depending upon international liquidity embracing a much broader spectrum of assets than gold alone. I recall vividly when then Under Secretary Roosa testified before a Congressional Committee one day and Congresswoman Griffith asked him point blank, "Why do men want gold anyway, Mr. Roosa?" In my long association with Bob Roosa, it was the only time I ever saw him at a complete loss for words. After a long silence, he said in effect that he did not pretend to understand all the psychological elements determining the mores of people but that he would simply say that the desire for gold was an inescapable fact of life in the international payments system. For my part, I see no reason to think that this will change in any sudden way over the years ahead. At the same time, the historical process by which substitutes for gold evolve and develop--evident in both domestic and

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

international monetary history--will certainly continue with undiminished inexorability. In fact, our international monetary system is not simply based on gold but on other reserve assets including, most importantly, the gold dollar, reflecting the present established price of gold. To illustrate this I have always found useful the analogy made to the Zen-Buddhist garden in Kyoto, Japan, which some of us saw after last year's Bank-Fund meetings in Tokyo. That particular garden has fifteen irregularly shaped rocks strategically placed in a bed of fine sand, and so placed that at any one time only fourteen rocks are visible yet the viewer is always conscious of a fifteenth rock. That fifteenth rock in our present world payments system is the established price of gold and the willingness of the United States to maintain the present value of the gold dollar. But that willingness cannot be simply a matter of oral declaration. It has to be based on the strength of our economy and on the public policies appropriately blended to maintain that strength, with price stability of the essence. So to my mind the most vital link between the morning and afternoon discussions is the value of the dollar itself.

My second, closely related, observation is perhaps more what might be termed a "nonlink" rather than a link between the morning and afternoon discussions. In short, it is that there is no international liquidity escape route from domestic liquidity requirements appropriate to the maintenance of sustainable expansion and growth. I have been

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

struck by the fact that much of the continental yearning for international monetary reform, and new forms of liquidity, basically reflects a desire to constrict the present degree of liquidity and in a way that would, as they see it, enforce monetary discipline upon the reserve currency countries. To be blunt, it is no secret that some European observers feel that our monetary policies in recent years have not been sufficiently restrictive--that our ability to finance external deficits with the dollar in its role as a reserve currency has exempted us from monetary discipline. Here at home, on the other hand, much of the academic and other clamor for greater international liquidity and for altering the international monetary system reflects the idea that this would enable much more expansionary domestic policies, monetary and other. In fact, both notions are in my judgment misconceptions. The answer to the first charge lies in the continuous and increasingly comprehensive efforts made to contain the United States balance of payments deficit, beginning in February, 1961, accelerated in mid-1963, and broadened in February of 1965--efforts which have not ignored the monetary area. In fact, the latest measures have had, and are having, a very direct and conclusive impact on bank lending abroad. The United States current willingness to explore new methods of reserve asset creation does not, and cannot, reflect any lessened determination to achieve equilibrium in our balance of payments. President Johnson made this very clear in his remarks at the Bank-Fund meetings this past week. Liquidity cannot replace dollar viability and dollar viability rests squarely on the continuance of appropriate domestic policies.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

A third, and similarly related, observation is that in no small measure international liquidity, and the role of gold in supplying that liquidity, is a function of attitudes and those attitudes cannot be divorced from domestic money policies. As I have said before, I am frequently tempted to philosophize that liquidity is simply a state of mind. For example, in recent years uneasiness abroad regarding U.S. domestic policies and our balance of payments position has affected the assumed needs for liquidity and the form of such needs. As a more specific illustration it may be noted that, even apart from legal requirements, attitudes towards the gold tranche as a reserve asset are importantly determinative of its place in the liquidity spectrum.

But there are other, perhaps no less fundamental, links between discussions of the gold and monetary unit and domestic money management (in which I would include both monetary and debt management policy).

1) The problems of determining the adequacy of domestic money supply--and there are no cut and dried formulae for doing this--are even more difficult when raised to the international level. Just as in the case of the domestic money supply, there is a clear need for some sort of standards to determine what the aggregate increase in reserves or other forms of liquidity ought to be as we move ahead in shaping the international monetary system. But in the world of fact there are no such criteria, and an appraisal of the needs for reserve assets over the years ahead

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

remains in the mystical realm just as much as the desire for gold itself. On this score I would add that just as there can, in my judgment, be no simplified rules devised to equate automatic money supply increases to domestic needs--that no such rules can be a substitute for judgment--this same principle, amply demonstrable in domestic monetary affairs, is true in international monetary affairs. No arbitrary link to gold or year-by-year provision of a fixed amount of gold based assets would be sufficiently flexible and adaptable to meet the varying international requirements.

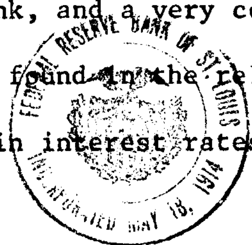
2) Again as in the case of the domestic monetary system, there is the question of the closeness of the relationship of any new international reserve asset to gold either in its creation or in its use. Both in domestic and international finance, as I have said, the historical tendency has been toward the increasing use of substitutes for gold. It would appear to be a retrograde step to establish a new form of international money rigidly linked to gold and useable only in conjunction with gold. But the much more difficult problem is how to build on and support the one gold reserve that sustains the entire system

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

by assuring gold convertibility at a fixed price. One solution put forth in a recent volume by Mr. Roosa entitled "Monetary Reform for the World Economy" is that all countries should assume the responsibility for buying and selling gold at a fixed price. Whether or not this is the answer, some answer must be found to the continuous erosion of the gold supply that forms the monetary base for the entire world payments system.

3) As we look backward toward the morning subject of gold and the monetary unit, and forward to this afternoon's session dealing with our domestic money problems, it seems to me that there is another link in the fact that changes in the money supply alone are not enough either domestically or internationally. Just as in our domestic monetary system the growth of credit facilities has proved to be an even more important part of meeting liquidity requirements, so is this true of the international monetary system. Thus the current increase being implemented in the countries quotas in the International Monetary Fund is a major contribution to the functioning of the system.

4) A final link, and a very complex and difficult one to unravel, is found in the relationship between differentials in interest rates, reflecting differing


LIBRARY

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

domestic requirements, and undesired and disequilibrating capital flows. The most obvious solutions, in terms of changes in internal policy mixes, are not necessarily consistent with the complexities of the problem in terms of the supplies and demands for funds here and abroad, and the various differing stages of capital markets. Classical remedies have, in fact, not been found adequate to cope with this unclassical problem.

In concluding these brief remarks this noon linking the morning and afternoon parts of the program I would be derelict if I did not stress the one link that stands out above all others. That link, evident in both morning and afternoon sessions today, is the standard of excellence that has been the hallmark of these Georgetown University Forums. I have been privileged, as I know a number of you have been also, to attend these Forums almost from their inception and to witness at firsthand the contribution they have made to stimulating thought and action on the more significant financial questions confronting us. For example, in the fall of 1963 I vividly recall the discussion on international liquidity carried on by Lord Cromer, Governor of the Bank of England, Dr. Holtrop, President of the Nederlandsche Bank, and also President of the Bank for International Settlements, and Dr. Otmar Emminger, Director of the Bundesbank. In the two years since then, in all of our discussions of the subject, both at home and abroad, I have not encountered a more stimulative or

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

provocative session. Uniquely, the Georgetown Forum discussions have not been abstruse academic analyses but rather have presented off the record the views of policy makers responsible for operations in their respective areas of competence. Thus, in my judgment, the Georgetown University Forum has well fulfilled its hopes expressed in the 1963 program that "this international meeting of bankers at Georgetown University hopes to provide a Forum for the free discussion of our national and international responsibilities in the interest of the public good." In these days and times that interest in, and benefit from, these kinds of discussions is even more compelling and augurs well for the future of these Forums and for the continuing need for this kind of searching exploration of those financial problems of paramount importance. And as you all know, in every way the quality of these Forums is a tribute to the personality and talents of Governor Matt Szymczak. So I close with this personal word of thanks to our former Federal Reserve colleague and long-time friend, Matt Szymczak, and want him to know that I take great consolation from the fact that a man can remain so young and vigorous and creative after retiring from the Federal Reserve Board.

****

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis