For Release on Delivery

(Approximately 9:00 p.m.
Friday, October 15, 1965)

PERSPECTIVE ON INTERNATIONAL MONETARY ARRANGEMENTS

Remarks by J. Dewey Daane

Member, Board of Governors of the Federal Reserve System

Before the New Hampshire Bankers Association

Mountain View House

Whitefield, New Hampshire

on Friday, October 15, 1965

PERSPECTIVE ON INTERNATIONAL MONETARY ARRANGEMENTS

The Bingo game scheduled to take place in this same hall beginning at 10:30 p.m. reminds me of an experience I had some years back in making a talk to a group meeting of North Carolina Bankers. At this particular group meeting, held in a large hall in Morehead City, North Carolina, there was a rather copious pre-dinner cocktail hour or more, followed by a leisurely dinner. After dinner the Chairman of the meeting undertook to introduce every single one of the some two or three hundred people present. Following this he called upon the then Banking Commissioner for North Carolina, Mr. Gurney Hood, to make a few remarks and Mr. Hood responded by talking for 40 to 45 minutes. In turn, Mr. Hood was followed by the Executive Secretary of the North Carolina Bankers Association who spoke for about 15 or 20 minutes. At exactly 11:00 p.m. the Chairman called on me to make the principal address and in his introduction said, "Immediately following Dr. Daane's remarks there will be a dance in this same hall" and at that point the orchestra in the back of the room began to tune up!

Tonight the New Hampshire Banking Commissioner, Mr. Dunn, has very graciously left ample time for the use of Mr. Bunting and myself and I only hope that we can make good use of that time. For my part I would like to talk with you briefly and informally on the subject "Perspective on International Monetary Arrangements". That perspective has shifted markedly with the decision reached at the time of the annual meetings of the International Monetary Fund and International Bank for Reconstruction and Development, held in Washington the week before last, to move into the first stage of negotiating new arrangements. The United States representatives, along with those of the other leading industrial nations comprising the Group of Ten, and with the active participation of representatives of the International Monetary Fund and other international organizations, namely, the Organization for Economic Cooperation and Development and the Bank for International Settlements, are now beginning to determine what basis of agreement can be reached on new monetary arrangements that can become an essential part of the fabric of the international monetary system. I am speaking to you at the outset of these negotiations not to try to outline any U. S. position or positions but rather to sketch in for you some of the background of these important negotiations, to try to go behind the scenes a bit and bring you up to date on where matters stand, and perhaps to indicate one or two guiding principles to which the United States adheres.

Last week I participated in a National Industrial Conference Board program in New York with the Managing Director of the International Monetary Fund, Mr. Pierre-Paul Schweitzer. In his address on the subject of international monetary reform he posed three questions--what are we talking about; why are we talking about it; and what can we do about it? Without either paraphrasing or basically viewing the questions differently from the Managing Director, I would like to elaborate for this particular audience my own responses to these questions, perhaps adding a fourth question--where is all the talk taking place?

First of all, as to what we are talking about, when we refer to new international monetary arrangements we are talking about two rather distinct and separable, but clearly related, problems. One of these, and the problem that has had the lion's share of attention and publicity, and was in fact the focal point of discussions at the Bank-Fund meetings in Washington the week before last, is the question of international liquidity and particularly what sort of reserve asset creating method would be best suited to ensure the adequacy of reserves to meet possible future world needs. By international liquidity, of course, we mean simply all of the reserves and credit facilities available to monetary authorities to settle imbalances in their balance of payments. The other problem, and some have even assigned it a higher priority, is that of the so-called adjustment process, or how countries in both surplus and deficit positions in their balance of payments can manage their affairs so as to move back into balance more smoothly and effectively! I would emphasize that corrective measures should not be confined to deficit countries.

Second, when we turn to the question of why we are talking about these two problems I think the key can be found in the relationships between them. On the one hand it is argued that as the U.S. succeeds in solving its own problem of balance of payments adjustment, U.S. dollars will no longer be available in the same way to meet the demands for reserves--demands which now normally take the form of demands for gold and reserve currencies, principally dollars. On the other hand, there is also a very important link--and a very obvious one--between the needs for reserves and overall balance of payments deficits. Clearly in the modern world the main reason any country needs reserves is to settle deficits if and when they occur. The bigger the deficits, and the longer they last, the greater the amount of reserves needed, although reserve needs cannot be considered in abstraction from the availability of external credit lines and the terms on which such lines can be utilized.

But in recognizing that the speed and efficiency of the adjustment process is importantly determinative of aggregate needs for liquidity and, correspondingly, that such liquidity provides needed time for adjustment, there are two mutually conflicting conceptions that merit clarification. One is that somehow there can be an international liquidity escape route from the hard road of restoring equilibrium in our balance of payments. The other is that controlled and restrictive reserve creation is necessary to, and can automatically ensure, discipline and the adoption of appropriate policies by deficit countries.

I have been 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 1960, broadened greatly in February, 1961, accelerated in mid-1963, and widened further in February of 1965--efforts which have not neglected actions in the monetary area. In fact, the latest measures have had, and are having, a very direct and conclusive impact on bank lending abroad. Thus, I would categorically deny the assertion of some continental bankers and economists that the reserve currency status of the dollar enables the United States to live consistently beyond its means and to flaunt the discipline of the balance of payments. And I would think that adoption by the United States of some of the extreme proposals that have been suggested to us would have led only to a reduced flow of world trade and to lower levels of economic activity not only here at home but throughout the world.

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 crystal clear in his remarks at the Bank-Fund meetings two weeks ago today. Liquidity cannot replace dollar viability and dollar viability rests squarely on the continuance of appropriate domestic policies.

The real point of contact then between balance of payments equilibrium--the objective and end product of adjustment--and international liquidity is <u>not</u> that more liquidity would enable reserve currency countries to avoid taking necessary adjustment measures, but is twofold. Unless the United States succeeds once and for all in dispelling skepticism re its ability to put its house in order, the conversion of dollars into gold can and will continue and can only be contractive of world reserves and world liquidity. As the United States succeeds, the outflow of dollars will no longer serve to meet in the same way the needs for world reserves and world liquidity.

The "why" as to discussions of new monetary arrangements, therefore, reflects two quite different viewpoints. On the one hand, the Europeans desire to impose what they conceive as more discipline on the United States by way of the reserve asset creation process, while the U.S. view primarily represents recognition that gold and reserve currencies may not be enough to meet potential world needs for reserves, and that it is only prudent to undertake contingency planning.

Third, as to the where of these discussions or, more accurately now, negotiations, I have already indicated that the principal forum presently is in the so-called Group of Ten Deputies, representing the ten leading industrial countries, which agreed in the fall of 1961 in their General Arrangements to Borrow to supplement the reserves of the International Monetary Fund. At the Bank and Fund Meetings the week before last, the Ministers and Governors of the Ten gave instructions to their Deputies to "determine and report to Ministers what basis of agreement can be reached on improvements needed in the international monetary system, including arrangements for the future creation of reserve assets, as and when needed, so as to permit adequate provision for the reserve needs of the world economy. The Deputies should report to the Ministers in the spring of 1966 on the progress of their deliberations and the scope of agreement that they have found." As a result, the Deputies of the Group of Ten, with each country generally represented by a senior treasury and central bank official, will undoubtedly be meeting frequently during the coming months to carry out the first phase of the work of contingency planning.

For progress with regard to the adjustment process, the Ministers and Governors of the Ten called upon Working Party-3 of the Organization for Economic Cooperation and Development. Like the Deputies of the Ten group, and with membership largely overlapping, Working Party-3 consists of senior officials of central banks and Ministries of Finance in those ten or eleven countries whose actions have the greatest influence on international payments. This group had been previously charged with making a thorough study of the measures and instruments best suited for achieving balance of payments equilibrium and now has been requested, hopefully, "to make their views known at about the same time as the Deputies of the Group of Ten report to the Ministers and Governors."

Fourth, turning to the last question of <u>what can be done</u> to reform the system and what sort of new monetary arrangements can be introduced, already a great deal has been done in the way of additional credit facilities in the network of Federal Reserve swap and standby swap arrangements, now totaling close to $3 billion, in Roosa-type bonds, and in substantial additions to resources of the IMF both by increases in quotas of member countries and by the agreement to provide supplemental resources in the General Arrangements to Borrow. But there has also been a wide variety of proposals for other new arrangements put forth over the past two years, some looking toward new methods of reserve asset creation within the International Monetary Fund itself and others outside of the Fund.

I do not intend tonight to make a detailed examination of these various proposals and of their possible merits and demerits. For that I refer you to the excellent report published last August of the Study Group on the Creation of Reserve Assets, under the chairmanship of one of the Italian Deputies of the Ten, Signor Rinaldo Ossola.

Most of the proposals under discussion are aimed at the deliberate and controlled creation of international reserves. Furthermore, most of them create reserve assets "out of thin air" in the sense that countries participating in the proposed arrangements would benefit from an increase in the reserves without giving up goods and services or accepting a capital inflow. Most schemes would also require some limitation on the freedom of countries to determine the composition of their reserves. For the schemes to be workable, participating countries would have to commit themselves to accepting the newly-created assets in payment for surpluses within agreed limits. In their other characteristics the various schemes for creating reserve assets differ considerably as may be seen in the so-called Ossola Report to which I have referred.

Finally, I would like to close with a few comments as to the guidelines or objectives on which the United States has consistently stood firm. The first is that any scheme should not be contractive of world liquidity. A new reserve asset should not be detrimental to existing liquidity. An important part of existing liquidity represents reserve currency holdings, and the attitudes of their holders are of vital concern in constructing an appeptable reserve asset that would add to, and not subtract from, present liquidity. Second, the first phase of preparation for new and improved monetary arrangements now underway in the Group of Ten must be followed by a second phase of preparation involving more countries in a wider forum. Secretary Fowler emphasized this point in his address at the Bank-Fund meetings stating that "there lies a second phase of preparation of the utmost importance, on which the United States has been both insistent and persistent in its pursuit of appropriate preparation for an international monetary conference. This second phase should be designed primarily to assure that the basic interests of all members of the Fund in new arrangements for the future of the world monetary system will be adequately and appropriately considered and represented before significant intergovernmental agreements for formal structural improvements of the monetary system are concluded. Within the Fund membership there are variations in the extent to which individual countries are able to, or choose to, accumulate and hold large reserve balances. All, however, have a vital interest in the evolution of the world's monetary arrangements."