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The 1970's: Reasonable Expectations

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The 1970's: Reasonable Expectations

By J. Dewey Daane*

It is a real privilege and pleasure for me to have the opportunity tonight to address this distinguished group of international bankers. But it also is with considerable temerity, as well as much trepidation, that I take a look forward with you at possible developments in the 1970's on both the international and the United States' domestic financial horizons. For I well recall that many in the United States a decade ago were confidently talking of the "soaring 60's", or even the "sizzling 60's", and then within a year were watching a presidential campaign in which the winner stressed the need to get the country moving again! In retrospect, the 60's did indeed finally soar, to be sure, but with far too much of the impetus and momentum of the upthrust attributable to the seduction and piracy of inflation and--in the United States at least--to the undesirable stimulus of war expenditures. That is why I have deliberately chosen the topic "Reasonable Expectations" rather than "Great Expectations", which might have been a more logical choice in this London setting. And I hasten to add that the only expectation of which I am completely certain of realization is that developments in the 1970's will, at best, only correspond in the roughest outline to anything we can now foresee, reasonably or no,

*Member, Board of Governors of the Federal Reserve System. I am grateful to several members of the Board's staff for assistance in the preparation of these remarks--particularly to Mr. Louis Weiner, Mr. Arthur Hersey, and Mr. Lyle Gramley.

and that we shall continue to find ourselves confronted both at home and abroad with the unforeseen and unforeseeable.

Against these caveats, however, let me try to look forward with you tonight to what we may reasonably expect to see in the 1970's. From my standpoint it would be much easier, and obviously safer, if one could make an heroic abstraction and leap over the intervening years to focus only on the latter part of the 1970's. But in fact I do not think this is feasible, for much of the shape and shadow of the developments to come on both the domestic and international monetary scenes will be dependent on what occurs in the intervening years. Taking the United States as an example, the developments during the late 1970's will be closely related to the contour of the economy in the early part of the decade and, specifically, to how well we meet the present challenge to find ways and means of reconciling our objectives of avoiding inflation, promoting employment, assuring sustainable economic growth, and achieving balance of payments equilibrium.

Perhaps it is provincial of me, but I think that the course of the United States economy, and our success at home in developing appropriate policies to meet the challenges confronting us, will have considerable impact on the international financial scene as well. Consequently, I am going to begin with an inward, but forward, look at the U. S. economic situation as a preface also to what I will have to say later on concerning the international monetary system.

"The other side of the valley", as you may know, is the currently fashionable phrase in Washington and New York to describe the economic pickup that is expected to follow the economic slowdown which fiscal and monetary policy have been aiming at and many believe is already underway. Those who use this phrase are often the people who are skeptical that any lasting good--in the way of stabilization of the price level--will come of the Administration's and the Federal Reserve's efforts to check inflation. The pressures toward higher money wages and profits are so strong, they think, and the universal commitment of modern governments to something near full employment is so binding, that they feel sure that the American economy will soon be rolling furiously up that hill on the other side of the valley--starting slowly, perhaps, but then going faster and faster. If that is really what is going to happen, my hopes for the 1970's are not very likely to come true, either for the United States or the rest of the world. Let me explain.

We have had an earlier preview of the risks concealed by the phrase, "the other side of the valley". Economic policy in 1966 succeeded in achieving during 1967 a slowdown in the pace of growth and a pause, for a few months, in the rise in wholesale prices. For nine or ten months we also had a slight decrease in imports after what had been a very steep increase. But by the end of 1967, prices and imports were both shooting up again. It is not easy to judge just how strong the underlying demand pressures in the U. S. economy are at any given moment, and steering policy on the narrow course of maximum employment without inflation is difficult if not precarious. We missed the right course rather badly, in 1967, and we compounded our mistake in the last half of 1968. We must make sure that similar mistakes do not recur this time. For my part, I am not convinced that the "valley" now ahead of us is going to be as pleasant--in other words as shallow or quickly traversed--as is popularly predicted, nor the ascent on the other side easily achieved without a great risk of regenerating inflationary pressures.

Here in Britain you seem to have tackled a similar problem and, after several unsuccessful tries at it, to be doing rather well. Your fiscal and monetary restraints have been really tough, and as far as I can judge you have achieved a real change both in expectations concerning the course of prices and in the balance of payments--yet without producing an untenable rise in unemployment. There is surely much to be learned by reflecting on the differences between your situation and ours, as well as on our similarities, so as to understand in some degree those elements which have contributed to your success which may possibly be relevant for us, and those which may not be.

Am I not right in thinking that one very important difference why, in your case, limiting price increases has more immediate balance of payments effects is that for you exports of goods and services are equal to about 20 per cent of gross national expenditure, while for us the proportion is less than 5 per cent? Once you were on the road to a healthy growth of exports, there must have been powerful leverage working in your favor: the more you could restrain domestic spending and bidding up of prices, the better your export orders became and the surer your protection was against an unacceptable increase in unemployment. It is precisely because foreign trade is <u>not</u> one of our main lines of business in the United States, comparatively speaking, that I feel that your experience is less applicable to us and the road ahead of us may prove quite different. For the U. S. the question is how long a period, and what degree, of restraint of domestic demand will we need to get back to relative stability in the general price level? What will happen in the meantime to our employment and unemployment? Even if restraints are adequate to the domestic economic problems, when can we expect real improvement in our balance of payments?

In a sense, too, it can be fairly said, I believe, that we are not as independent of the rest of the world as you are. This may seem paradoxical. But the hard kernel of the truth in this is that we must respect the role of the dollar at the center of the international monetary system. In your case, when the time came, you were able to alter the exchange parity of the pound sterling against the world's other currencies. The stimulus which that gave your exports worked hand in hand with your fiscal and monetary policies to restore financial stability without economic contraction and to improve your balance of payments position. We, on the other hand, must assume a passive role on exchange rates and it is other countries that set their rates in terms of the main reserve and transactions currency, not vice versa. This seems to me inherent in the present structure of the system and in the economic weight of the U. S. It is true even apart from the fact that any implied rise in the monetary price of gold in the United States, and every other devaluing country following suit, would strike a crippling blow at the efforts we have all been making to retain the proven advantages of an international monetary system based on the present gold price and related relatively stable exchange rates, while moving forward to meet the growth needs for reserves in a way that undergirds the system.

The consequence is that we must rely, as we have, on maintaining a better price performance than our neighbors overseas if we are to keep our economic growth path and balance of payments in line. But our own efforts to get our economy back on the path of growth without inflation, and to get our international payments into balance, can be blunted, or even thwarted, by the policies and actions of others. As to what kinds of reinforcing actions would be helpful the question answers itself. We need a general climate of price stability in world markets, to which others as well as we ourselves must contribute. We need a steady expansion of demand in world trade, and also liberalization of trade practices and dismantling of uneconomic barriers. We naturally anticipate devaluations will occur--they seem to come--as other currencies get out of line. Beyond this, revaluations of currencies of countries in surplus when their surpluses become structural may be appropriate from time to time in the interest of the international monetary system. Despite its tardiness the recent German action is a case in point. For "downward only" exchange rate adjustments make the system untenable and make even more difficult, if not impossible, the U. S. task of pressing toward sustainable equilibrium in our balance of payments.

There is, in fact, a very general and extremely widespread inability to conceive the reality and comprehend the significance of the shrinkage of the U. S. current account balance--strictly, I should say, the balance on goods and services--which has declined from a $7 billion average in the years 1963 to 1965 to only $2-1/2 billion in 1968 and then to an annual rate of $1-1/4 billion in the first half of the present year. Next year we hope for a balance somewhat larger than in 1968, under a favorable conjunction of demand forces at home and abroad. It is perhaps not surprising that this "sea-change" (a rather nice euphemism for deterioration) our international accounts have suffered has been rendered invisible by the astoundingly large inflows of private capital to the United States that have occurred since the middle of 1967. Unfortunately the character of these inflows is not necessarily durable, dependent as they were on the pressures our Government put on U. S. business corporations to finance their foreign investments with foreign borrowing, on the attraction of funds to our stock market, or on the pulling in of funds through the Euro-dollar market. The small size of our current account balance, on the other hand, is a too too solid fact, reflecting the impact of the excess demand we have experienced in recent years on the structure of our costs and prices relative to those abroad. It is depressingly illustrated by the failure of the goods and services surplus even to equal the $4 billion annual net outflow of Government credits and economic grants, to say nothing of the annual outflows of private capital.

Perhaps this gives you some indication of what I mean by the challenges ahead. We cannot, at this moment, foresee how long it will take to get back on a path of steady growth with reasonable price stability, nor how long it will be before our international payments reach a viable equilibrium. With unremitting efforts to pursue our domestic restraint policies and an understanding response by our friends abroad to the shape of the adjustment problem, we may feel confident of the ultimate outcome. But the challenges are real.

Recently I had the opportunity of hearing the very able former Chairman of the President's Council of Economic Advisers--Mr. Arthur Okun--address himself to the problem of the achievement of high employment, without price inflation, and ~~of~~ economic growth. His own "tradeoff" in the search for economic growth while avoiding inflation and undue unemployment was to compromise on a lower than desired, and potentially possible, annual rate of economic growth, and a somewhat highet than desired annual rate of price increase. Unfortunately this sort of compromise may not be good enough for our economy, either in our own interest or the world's interest. From my own standpoint, I do not think we can look forward to sustainable economic growth in the United States in the 1970's unless we are successful in dealing with the problems of inflation and inflationary expectations. An acceptance of "creeping inflation"--e.g. a 3% "crawl"--would, it seems to me, be self-defeating. As President Nixon put it in his address to the nation a month ago "the only thing we have to fear is fatalism" as to rising prices.

I do, however, agree with Mr. Okun on what he seemed to be saying as to a key area for action in our search for a way to curb inflation and promote sustainable growth with high employment. Here I am referring to the area of wages and prices--an area which is of concern in the United States and an area whose importance has not been lost upon the United Kingdom. And that, in turn, raises the open question of an effective approach to an incomes policy. The way in which we in the United States tried to use price and wage guidelines as substitutes for monetary and fiscal measures, in the face of the inflationary environment of the 60's, unduly reflected discredit on the entire concept in our country. Maintaining appropriate overall stabilization policies is still our single greatest need. But assuming an improved, while undoubtedly still inexact, fiscal policy and a somewhat better record of performance on the monetary policy side, I think one should ask whether we might not also be able to improve our record by devising some form of incomes policy as a supplement to overall stabilization measures. The question is relevant to the possible dilemma which we may face of slower growth with rising unemployment, on the one side, and faster wage increases and rising prices on the other. I am hopeful that ways may be found to restore some role to incomes policy within the framework of overall stabilization measures.

This is not a recommendation for direct price and wage controls to which I am completely opposed under present and foreseeable circumstances. They tend at best to suppress manifestations of inflation and to mask serious distortions that plague the economy long after controls are removed. Furthermore, they lead to economic inefficiencies and inequities and have heavy associated costs, including a costly administrative bureaucracy. And finally, they are likely to lead to attempts by both management and labor to flout the spirit--if not the letter--of administered decisions.

The problems and choices with which U. S. policy-makers are confronted under present circumstances are both obvious and difficult. There are risks of holding on to restraint too long, but there are also risks of letting go too early. No one wants unemployment to rise; and no one wants inflation. The cliche these days is the "tradeoff" policy-makers are willing to accept. Such a value judgment assumes we have matching, reliable schedules of unemployment versus inflation--a state we are far from reaching. But my own value judgment is clear; the danger of prematurely letting go--especially in the face of potential slippage on the fiscal side--is much the greater danger.

Clearly, it will take some time to unravel the snarl of the price-cost spiral that has developed in recent years. It will also take determined and flexible monetary and fiscal policies, given the insistent demands for all sorts of goods and services in the U. S.--an insistence that has not abated for more than relatively short intervals in the post-war period. While there is no spectre of a budget deficit of the fiscal 1968 magnitude, I am concerned about the present outlook in view of uncertainties on both the revenue and expenditure sides of the budget. On the revenue side the uncertainty regarding the surtax extension, investment credit repeal, and impact of tax reform raises the possibility of a sizeable deficit in this fiscal year, and even more so if expenditures were to exceed budget estimates. Looking further ahead, the phasing out of the surcharge together with prospects for sizeable expenditure increases, makes some increased fiscal stimulus nearly inevitable. Possible slippage on the fiscal side may make it even more necessary to hold steady on the monetary policy side in the near term and threatens to place too much of the burden on monetary policy in the longer run.

But this is <u>not</u> to say that monetary policy will not ease when easing is called for by the economic situation and the mix of stabilization policies. The trick will be in the timing and the magnitude of action. One of the lessons of the past is that we are likely to make mistakes; but another lesson is that we do survive and grow. As Herbert Stein, a member of the Council of Economic Advisers, said recently: "The economy is not poised on the razor's edge, ready to plunge into disaster at the slightest error. If this were so, we would not still be here."

To sum up what I have been saying about the prospective timing and dimensions of the transition period, the first point I would like to emphasize is that while growth in demands and real output seems to have slowed, and further slowing is generally agreed to be in prospect, policies should not shift to abrupt and massive easing at the first signs of rougher going and, in fact, at the moment we must try even harder to maintain an appropriate fiscal policy. The second point of emphasis is that getting the rate of price increase down to tolerable, acceptable limits will take time. I doubt that we can achieve this by the end of next year but, hopefully, we shall make appreciable progress and achieve our goal of price stability sometime soon thereafter.

If we are successful in getting the U. S. economy on the track of stable, noninflationary growth in a couple of years, what then for the remainder of the decade?

First, I am confident that demands--private and public--will be strong enough to place an effective claim on our potential real growth. Though growth will be irregular there should be no reason for our economy to become stagnant at any time during the 1970's. Second, many issues revolve around how the benefits of future growth will be shared--both within the private sector and between the private and public sectors. The general expectation in the United States--and one which I share--is that demands for public spending and investment will be urgent. Public spending has come to be viewed as an appropriate instrument--within a free market society--of meeting legitimate social needs that cannot adequately be met by individuals acting as such. In principle, the role of government has always been viewed in this way. The difference in the U. S. today is that our most urgent problems are of the sort requiring action by the public sector and this has greatly widened the scope that many are willing to ascribe to government.

Government today is viewed as capable of improving the quality of life and bringing about a more equitable distribution of incomes rather than, as in earlier times, being viewed simply as the main instrument of economic stabilization. I shall not enumerate at length the various specific programs to which the several levels of government are committed or may be committed in the years ahead. They range from defense to urban renewal, roads, education, minimum income maintenance or welfare, old age insurance, medical care, preventing pollution of air and water--and what not? And, significantly, some major programs are of fairly recent origin, and are likely to expand even more. Thus I have no doubt that government expenditures will increase substantially over the next decade.

But this simply reinforces the several bases for expecting strong demands for private fixed capital as well. An economy with vigorous demands in other sectors will inevitably stimulate demands for expansion of capacity and modernization of existing equipment. Technological advance and pressures for minimizing labor costs will provide additional incentives. To these classical underpinnings of business fixed investment we must add the widely recognized urgent needs for housing in the United States, both new housing and rehabilitation of existing substandard facilities. (For such a relatively young country, we seem to have developed an inordinate number of slums in our central cities.)

The heavy demands for business fixed capital and for housing, along with related capital requirements, when taken all together suggest sustained pressure in the decade ahead on the money and capital markets. If the Federal government at best shows only a more or less balanced fiscal position over the decade, the corollary will be a continuation of high interest rates in the United States. I need not, and cannot, specify how these rates will compare with recent interest rates but, if my assumptions are realized, rates will remain generally high. Thus an important point both of conjuncture and parallel between the U. S. domestic and the international monetary scenes is in the prospective levels of interest rates worldwide and the implications for growth and development throughout the free world. As I peer into the 1970's, I foresee a world in which capital demands far outstrip supplies. And with no diminution of basic demands, I see little likelihood of interest rates declining to earlier relatively low levels. In the United States, for example, credit demands in the wings at the moment may deter or cushion downward rate movements when and if an easing of the monetary brake becomes appropriate. And as has been evident in 1968 and 1969 U. S. rate levels are not irrelevant to rates elsewhere as the international money market has grown in size and increased in fluidity.

As I turn, then, to begin looking outward at the international monetary scene does this mean that I foresee a repetition of the strains of the 1960's? The answer is "no." As I look ahead to the international monetary scene in the 1970's, I think the reasonable expectation is that we will be in calmer waters --the phrase used by many of the world's leading financial officials at the annual meetings of the International Monetary Fund and World Bank a little over a month ago. My hopes include three key elements: First, a general worldwide stability of price levels--relatively speaking, in comparison especially with the last few years--coupled with steady economic growth; second, a much greater degree of balance of payments equilibration than we have seen of late; and third, further development of an international monetary system in which gold, SDR's, and dollars will all play important roles, with a steadily increasing quantitative place for SDR's.

It is mainly on the third of these elements that I want to develop some thoughts tonight. I hardly need to justify putting hopes for stable growth and payments equilibrium at the head of my list. Without them there would be little point in trying to think about an ideal international monetary system; we should all be occupied in putting out brush fires--or controlling real conflagrations. But I find several encouraging bases for an optimistic vista on the international scene.

First of all, by the year 1973 we will have created, and be using, almost $10 billion of special drawing rights, the new reserve asset that represents the successful culmination of our prolonged quest for an international money to supplement gold and dollars. This creation of SDR's, in an amount approximating one-fourth of the world's monetary authorities' present gold holdings, means that the desired growth of world reserves can and will be accommodated in ways supportive of, rather than inimical to, the adjustment process. Some two and one-half years ago, my good friend Jeremy Morse, Director of the Bank of England, spoke to this same group on the need for, the possible nature of, and the outlook for, the creation of a new reserve asset--this was in March, 1967 even before the SDR per se had been devised--and guessed that "a new reserve asset will be added to international liquidity, though when, in what form, through what agency and under the pressure of what events, may yet be uncertain." I can only hope that two and one-half years hence my guessing will prove to have been as accurate as his!

As I look back over the long history of our efforts to bring into being this new reserve asset, a number of the high spots in that search occurred here in London, at Lancaster House. But of them all, one of the most dramatic, in my memory of events, was when a seemingly major impasse, presaging a breakdown of our discussions and negotiations, was resolved when Chancellor Callaghan, then chairing the meeting of the Ministers and Governors of the Group of Ten in London, said simply, "Gentlemen, we have to reach an agreement if we have to stay here all night, and I, for one, have a <u>very broad bottom!</u>" At that point, with the tension broken, the meeting was suspended temporarily and, following consultations, the stumbling block was removed. (If I recall correctly the solution was the reconstitution formula in the use of the asset.)

But, to return more to substance, SDR's do represent a milestone in the evolution of the international monetary system and can only serve to strengthen its functioning in the 1970's. Frequently, I am asked the question as to how the SDR's may be used in practice. Some knowledgeable observers believe that they will sink to the bottom of the pile of reserve assets alongside of gold and be used rarely. For my part, I do not believe that this will be the case. I think that the SDR's will be used in a variety of ways, many of which will only develop as countries have the asset in hand to use. They will surely be used differently by various countries.

As to use by the United States, undoubtedly transfers of SDR's from the United States to other countries will be used alongside, and interchangeably with, gold sales and IMF claims to meet specific needs as they arise. Basically, over the years we will want to add to reserves from time to time, just as other countries have, and indeed SDR's provide our only hope for building up our basic reserves. We are starting from a position in which other countries' reserve claims on the United States have decreased over the past two years. As compared with the position at the middle of 1967, when total liquid and near-liquid U. S. liabilities to foreign official holders were $17.3 billion, the amount at the end of June 1969 had been reduced by $1.3 billion, to $16.0 billion. Starting from the end of 1967, the decrease amounted to $3.3 billion. However, in the last few months these liabilities have been increasing again.

Apart from the use the United States will make of SDR's, the extent to which other countries will use them is not clearly foreseeable. No doubt some will prefer to economize on their dollar balances, using dollars to meet their deficits and taking SDR's in times of surplus to the full extent the new rules may permit them or require them to do so. Others, in all likelihood, will value the higher interest return on dollar assets above the gold-value guaranty on SDR's, use the latter to meet their deficits, and take in dollars when they can. In the long run the ideal to be hoped for--in my view--is that considerations of these kinds will lose their importance. (Perhaps that will mean some day increasing the rate of interest on SDR's above any rate hitherto contemplated.) As the volume of SDR's grows over the years, all reserve assets may come more and more to be viewed as equals in the central bank till. There would then no longer be a role for the working of Gresham's law as a determinant of the form in which national reserves will be kept.

Under this regime the old riddle of what is the difference between a dollar-exchange standard and gold-exchange standard would lose all its point. No one would be able to say whether the SDR is based on gold and the dollar or the dollar on the SDR and gold.

Diehards in some countries might still complain, if they liked, of the loss of economic independence entailed in the adherence of their countries to this SDR-and-dollar system (with gold a diminishing proportion) but the words would be hollow. There would be nothing to prevent any country--other than the United States--from changing its currency parity whenever that became necessary and, let us hope, by then there could even be positive incentives under international arrangements for a country to do so when an up-valuation of its currency is what it, along with the rest of the world, needed.

But aside from the question of the relative use, or ultimate use, of the SDR asset, it will be, as I see it, used in the near term just as other assets are used in meeting reserve needs connected with the functioning of the adjustment process. Most importantly, the mere existence of the SDR's makes possible the smoother working of that process--and this is what I look forward to in the 1970's. Clearly, SDR's do not insure or guarantee that the international monetary system still will not be subject to stresses and strains, and to major disturbances from time to time, but they do provide a means, founded in international cooperation, to reconcile the reserve needs and objectives of both the surplus and deficit countries, without resort to disruptive policies. For on this score surplus countries have their parts to play, too.

And perhaps this is the point at which to remind ourselves that the inward essence of the whole idea of creating reserves by international fiat is to ensure that a world shortage of reserves will not hamper the adjustment process, that fears of suffering a decline in national reserves--now to include freshly allocated SDR's--will no longer cause countries with surpluses to follow policies that frustrate the attempts of others to stop having deficits.

Another related and supplemental, but significant, source of strength as we look forward to the 1970's is in the expanded credit facilities, which have proved so tremendously helpful in meeting growing credit needs including those arising from short-term speculative and other money flows. In the 1960's, the general overall increase in IMF quotas, plus selective increases, brought Fund resources to around $21 billion. A further general increase in quotas, along with selective increases, is in process and prospect so that the size of the International Monetary Fund, in terms of the total of member-country quotas, may grow by about a third, to around $28 billion--and another quinquennial quota review will be due in mid-decade. Along with all of this perhaps you will forgive me for speaking with parochial pride about the further development of the Federal Reserve swap network--the network of mutually reinforcing credit lines--now totaling nearly $11 billion. In terms of its demonstrable usefulness, since the network's inception in 1962 the volume of swap transactions in both directions has amounted to about $20 billion--an impressive record!

So, indeed, the credit facilities have been, and are being, expanded in a way that provides a basis for coping with the expanded credit needs associated with the substantial enlargement of the world economy that we may confidently expect in the 1970's, and the larger needs associated with the continuance and expansion of a convertible currency world.

This brings me to another source of optimism about the near-term future. As we look into the 1970's comfort can be found in the relatively recent realignment of exchange rates of major currencies and, especially, the 9.3% revaluation of the D mark which, as an undervalued currency, was a major destabilizing factor whenever and wherever pressures arose in the system itself. I think these moves were appropriate and will contribute to stability in the period ahead. One of the lessons, however, of the 1960's is that it is essential, also, and this is no contradiction, to remove or lessen undesirable rigidities in the international exchange rate system, that is, to provide in some way for changes in established parities, when they become necessary, without long delays. And here I feel quite certain that we will move forward on those lines, not simply by force of necessity but, again, as the result of international study and cooperation.

I do not intend tonight to be more specific in forecasting the nature or timing of the added, though still necessarily limited, exchange rate flexibility that one can envision in the 1970's, but I do sense that it will and must come. There are almost overwhelming difficulties and problems connected with building into the system a somewhat more responsive adaptability of exchange rates to underlying changes in the relative economic positions of nations. Some of these problems are transitional, others longer run such as in capital movements and the implications for domestic policy independence. If any variant is to prove practical, a way must be found to get around these difficulties and enable the system to adapt more flexibly--without, at the same time, bringing a significantly greater degree of uncertainty into international transactions, and provoking more, rather than less, speculation in the exchange markets. And, as Secretary of the Treasury Kennedy emphasized in his remarks at the Bank-Fund meetings, all of this must also be accomplished in a way that will not provoke a bias toward devaluations--a bias that has been far too prevalent in the decade behind us.

But, looking ahead, I believe we will be grappling, and successfully, in the 1970's with the problem--or, more accurately, the necessity--of introducing somewhat less rigidity into a system consisting essentially of relatively fixed exchange rates. While this is a large undertaking, I believe we will once again see a solution emerge from the continuance of the remarkable international financial consultation and cooperation developed during the 1960's.

Another far from insignificant source of strength in the system in the 1970's can, I believe, be found much closer to home for my audience tonight in the basic improvement in the United Kingdom's situation, both domestically and externally. It indeed must be a source of real satisfaction to all of you, a satisfaction which we share vicariously at least, that the United Kingdom has once again joined the ranks of the surplus countries!

Last, but not least, in my catalogue of supports to the international monetary system in the 1970's is the durability of the two-tier gold system, dating from March 1968. Since then there has been much confusing and inaccurate talk about the demonetization of gold in the international monetary system. Just a month or so ago, I heard Professor Lamfalussy deliver the Per Jacobsson lecture on the role of gold, looking forward to the time when it will be displaced in the international monetary system. For my part, I do not interpret the two-tier system, itself, as representing the demonetization of gold. Rather I think it has served to insulate the monetary system from fluctuations in the supply and demand for gold and has thus contributed to greater stability. Reassuringly, a way has been provided for a deliberately and judiciously created asset, the SDR, to meet the major part of the growth needs for reserves, while keeping a place for gold as long as any country wants to use it as a part of its own reserves. As I look down the road ahead, I would simply expect gold to play a relatively diminished role in the international monetary system, while SDR's become the main growth element in total reserves.

In all of these circumstances, we can expect a final liquidation of suspicions that the United States might change the official dollar price of gold. In an SDR world a gold price change would represent even more of an anachronism than it would have in the years leading up to the SDR's. The decision having been reached to provide, henceforth, for the deliberate and equitable creation of reserves as needed--to meet growth requirements without provoking inflationary pressures and to implement a smoother working process of balance of payments adjustment among nations--a gold price change is indeed unrealistic. Thus even if the market price of gold should rise, I think we can reasonably count on the continuing successful operation of the two-tier system.

An alternative tactic for the United States is sometimes urged: to let surplus countries take care of themselves and simply let them worry each other about the value of the dollars they accumulate in their reserves--and the amounts of those dollars which they hold. I consider such ideas wrong-headed and mischievous. Too much is at stake for the United States and the rest of the world in the future development of the SDR system in particular--both as a bulwark and as a consequence of international financial cooperation--and in harmonious economic relations in general, for us to risk the destruction of the new edifice by some devil-may-care attitudes on the part of the United States. Too much depends on cooperative action by and among surplus countries for us in this country to walk away from the responsibility for the supply of our own dollars in foreign hands. To justify that cooperation, and to foster and preserve the life of the system, it is essential to maintain the value of the dollar.

This then brings me full circle in my remarks this evening. I began by stressing the close ties between financial developments in the United States and the rest of the world. I should reemphasize that the hopes I have been describing are for the future. If there is to be an SDR future the international monetary system must get through the first two or three years of SDR creation in creditable fashion. To make that possible, the United States has a big hump to get over on the other side of the valley, as well as a tortuous path through the valley. But much of what I see ahead seems to lead one to be reasonably optimistic. Last summer, Lord Cromer, in discussing the British banking system, said that "metaphorically speaking, it may be a plumber's paradise [in terms of money flows] or an economist's Elysium, but for a banker, it is Bedlam." For my part, I do not see bedlam ahead in the 1970's but, assuming the continuance of the unprecedented international financial cooperation of the 1960's, an exhilarating decade in which perplexing problems are met by constructive change.