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Member Bank Services Conf.
Great Falls & Billings, Mont.
Sept. 20 & 21, 1967

AN ASSESSMENT OF CURRENT MONETARY POLICY

Of late, I have been taking every opportunity to urge support of the President's call for an increase in taxes. Nor am I going to relent today. I am more convinced than I was even two or three weeks ago that an increase in taxes is imperative.

Unless something is done to curb demand for the nation's output, we are going to have more inflation in 1968; and a good deal more, not just a little more. But we should, I believe, want very much to avoid more inflation; above all, because it is a capricious, inequitable form of taxation. Then, too, further increases in our prices would not make it any easier for us to get our international account into balance. Mighty as the U.S. is economically, time may be running out for it.

There are, of course, various ways in which overall demand for the nation's output could be curbed. The government could cut its non-defense expenditures. It is easy to sympathize with this alternative to a tax increase, although with what we have lived through in recent months, one can reasonably wonder whether now is the time to cut welfare expenditures further. Deferring social maintenance programs too long has the cumulative effects of postponed equipment maintenance. The longer you put off the repairs the bigger the risk of eventual major breakdowns. In any event, cutting nondefense expenditures is not a practical alternative to increasing taxes. Some cuts have already been made, and more will be, I am sure. The fact is, though, that nondefense expenditures cannot be cut sufficiently. Nor in the pinch would you want them to be. A sufficient cut would lop off programs which all of you think of, not as frivolous, but as essential. Perhaps the business community is wise to insist on some cuts in nondefense expenditures as the price of its support for an increase in taxes.

But hopefully it will not kid itself that cutting expenditures is a practical alternative to increasing taxss.

Instead of increasing taxes, we might increase interest rates. This is another alternative. But if we rely on monetary restraint alone, as we did in 1966, the resulting credit crunch will by comparison make 1966 seem like a year of easy money. This is what Chairman Martin and former Secretary of the Treasury Dillon told Congress last week, and I have no doubt but that they were right. So again I come back to my point; there is no practical alternative to increasing taxes. I sincerely hope all of you realize this.

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Let me turn now, however, from talking of the pressing need -- or should I have said depressing need -- for an increase in taxes, and talk briefly about the plan for increasing the world's monetary reserves which will be adopted by the International Monetary Fund in a week or so. The special drawing rights plan, as I shall refer to it, has been hailed by the President as the "greatest forward step in world financial cooperation in the twenty years since the creation of the International Monetary Fund itself." For myself, I would find it hard to take issue with this claim.

For a number of western countries -- chief among them, the United States and the United Kingdom -- the object of international monetary reform has been to increase the supply of international reserves or money, and to ensure that this supply will in the future increase as the volume of world trade increases. Nor is the reason for their having adopted this objective difficult to find. The supply of international reserves has increased hardly at all in recent years. Each year, of course, more gold has been produced. But production has not kept pace with world trade. Moreover, newly mined gold as has been going not to the western world's central banks but to speculators and others bought up the whole of the 1966 output of gold, and more besides, so central banks' combined holdings of gold actually decline.

For many years, central banks in other countries were happy to increase their international reserves by accumulating dollars. And with the U. S. running deficits and thereby supplying dollars to the world, international reserves did increase for awhile. But central banks in other countries have become reluctant holders of dollars. Increasingly, they have come to want not more dollars, but gold.

For one country -- even a country as economically dominant as the U. S. is -- to run continuing deficits is not a satisfactory way of increasing international reserves. It is just that as foreigners' holdings of any country's currency increase, the currency must become more and more suspect, and therefore less and less acceptable as a reserve asset. In the event, this is what has happened. Nor is it clear that the U. S. would willingly run deficits indefinitely, even if this were the only way of increasing the supply of international reserves.

Anyway, with the production of gold increasing little from year to year, and the dollar becoming less acceptable as a reserve asset, the search has been then for a new kind of international money. Which is what was invented in London last month. The special drawing rights, so-called, are international money.

The London plan is essentially this: once the plan is put into effect, then the members of the IMF will decide the amount of special drawing rights to create each year, and each member will get its pro rata share. Each year, then, countries belonging to the IMF will find their international reserves increased by the amount of their shares of the newly created special drawing rights. These special drawing rights can be used to purchase the currencies of other countries -- or, in other words, to settle international deficits with other countries. Countries must accept these drawing rights as money, at least up to some limit, or provide their currencies in exchange for this new kind of money, but can in their turns use accumulated special drawing rights to cover deficits of their own.

For the special drawing rights plan to be put into effect, it is required that 85 per cent of the IMF votes be cast in the affirmative. And for any amount of special drawing rights to be created, 85 per cent of the votes must be cast in the affirmative. Since the common market countries have more than 15 per cent of the IMF votes, they can veto putting the plan into effect; and they can veto the creation of any given amount of special drawing rights. These countries were given veto power in return for their approving the plan itself. Which is perhaps reasonable enough, since together they are an economic power of great significance. The question arises, though, whether the common market countries will vote as a block, and, until the U.S. gets back into payment balance, veto putting the London plan into effect. There are many -- among them, former Under Secretary of the Treasury, Robert Roosa -- who think not. For myself, I would only point out that the other common market countries have not invariably followed General De Gaulle's lead.

The French have claimed that the London plan was a victory for them, and the phrase "special drawing rights" would seem to suggest as much, since all along Finance Minister Debrue has argued against creating new international money and for creating new international credit lines. But a new kind of international money was created in London. The special drawing rights can be used, as I have said, to cover international deficits, and up to some limit do not have to be paid back. Which would seem to indicate that they are money, not credit. So it is the U.S. which won the victory.

It is easy for outsiders -- for those who have not been locked in mortal combat with the French -- to be skeptical of the special drawing rights plan. But time will show, I believe, that in approving the plan the western world took a big step forward. One thing, though, is perfectly clear. It is extremely fortunate that some kind of plan was approved in London. Had the August London meeting broken up in disagreement, the situation could have got very grave. It may be that Secretary of the Treasury Fowler did not fully appreciate the risk he was taking when, four years ago, he issued his call for international monetary reform. After agreement on the special drawing rights plan was announced, gold shares tumbled and demand for gold in the London market decreased rather sharply. Had there been no such announcement, though, speculation against the dollar would almost certainly have become much more intense than it had been.

There has long been a fear, undoubtedly justified, of governments printing money to pay for their own expenditures. Now an international organization, the IMF, or a collection of governments, is going to print internationally accepted money, so some will be fearful of a world-wide inflation just a few years off. For myself, I would be skeptical that when the IMF membership approves the special drawing rights plan, it is going to be like the Spanish discovering Aztec Gold all over again. The western world's government's central banks are entirely aware of the inflationary danger inherent in the London plan. They are not to create special drawing rights in irresponsible amounts. They are going to create international money, to be sure, by only enough to prevent the western world from slipping into a deflationary spiral caused by a shortage of international reserves.