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TOWARD A WORLD CENTRAL BANK?

Monday, 14 September 1970

AULA DER UNIVERSITÄT — BASLE, SWITZERLAND

Corrigendum

Page 46, line 14: delete “needs”

TOWARD A WORLD CENTRAL BANK?

THE PER JACOBSSON FOUNDATION

Lecture and Commentaries

by

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1700 hours, Monday, 14th September, 1970

Aula of the University—Basle

FOREWORD

The Proceedings of the 7th lecture meeting convened by The Per Jacobsson Foundation are contained in this publication. It includes a background paper on the subject "Toward a World Central Bank?" prepared by Mr. William McChesney Martin and his oral presentation of this paper in the Aula of the University of Basle on 14 September, 1970. The commentaries of Dr. Karl Blessing, Mr. Alfredo Machado Gómez, and Professor Harry G. Johnson are also reproduced, along with the welcoming remarks of the Rector of the University, Dr. Eduard Wenk, and the introductory remarks of the President of the Foundation, Mr. W. Randolph Burgess.

This series of lectures and publications is made possible by the generous contributions to the Foundation made by friends of Per Jacobsson, late Managing Director of the International Monetary Fund, following his death in 1963. The Foundation was established to promote informed international discussions of important current problems in the field of monetary affairs in which he had always taken so active a part. Elsewhere in this pamphlet will be found a list of the Proceedings and other publications so far issued by the Foundation. These are made available, without charge and upon request, in English, French, and Spanish. In addition, through the kindness of banks and bankers' associations throughout the world, excerpts from the Proceedings have been issued in Chinese, German, Hebrew, Italian, Japanese, and Persian.

Enquiries may be addressed to the Secretary at the address given below.

The Per Jacobsson Foundation
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Washington, D. C. 20431

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OPENING REMARKS

Dr. Eduard Wenk:

It is with great pleasure that I welcome your organization on behalf of the University of Basle. The first lecture meeting of the Per Jacobsson Foundation was held in this auditorium in 1964. Subsequent assemblies have taken place in the United States, Latin America and Europe. Today, our University has again the privilege to welcome your organization for its seventh lecture meeting. Evidently there must be close ties between your Foundation and the city of Basle.

Per Jacobsson was Director of the Economic Department of the Bank of International Settlements from 1932 to 1956 and lived for twenty-five years in our town. In 1949 he received the degree of Honorary Doctor from the Faculty of Philosophy and History of the University of Basle. In 1952 he took a lead in setting up the Basle Center for Economic and Financial Research which is closely connected with our University. Dr. Jacobsson left Basle in 1956 when he took up the duties of Managing Director of the International Monetary Fund in Washington. We hoped that he would return to the Basle Center after his retirement; unfortunately, his untimely death in 1963 had put an end to these plans.

Friends of Per Jacobsson established the Foundation which bears his name in 1964. According to its charter, one of the main purposes of the Per Jacobsson Foundation is to foster and stimulate discussion of international monetary problems by organizing lectures to be given in different countries and languages.

It is a great honor and a pleasure for the University of Basle to welcome you all to this town, and I wish you a successful meeting.

* * * *

W. Randolph Burgess:

Dr. Wenk, we thank you sincerely for your welcome. The fact that we have come back again after six years to meet here in Basle shows how we appreciate the part that this city and community played in laying the foundation for the brilliant career of Per Jacobsson and the enormous contribution that he made to international finance all over the world. So the first thing I must do is to express our thanks to you, Dr. Wenk, to the Bank for International Settlements, and not least to the City and Canton of Basle.

As we look back to that first meeting in 1964, we are saddened by the knowledge that our two distinguished speakers on that occasion, Maurice Frère and Rodrigo Gómez, were both taken from us by death in the past month. They were extraordinary men who had demonstrated both within their countries and elsewhere the value of sound and courageous financial policies. The expositions which they gave us at that meeting of their problems and policies were widely read and acclaimed in many parts of the world. As you know, Mr. Frère was for over ten years the effective and honored President of the BIS.

Turning now to the adventurous subject of today's conference, we are reminded that this is an anniversary year in the development of monetary cooperation. The BIS began its operations 40 years ago. While its birth was a direct product of the Young Plan for a German settlement, its paternity really goes back to earlier, less formal beginnings in central bank cooperation under the leadership of Montagu Norman of the Bank of England, and my old associate and chief, Benjamin Strong of the New York Federal Reserve Bank, who, working with the heads of other central banks, gradually developed the principle of personal contact. I once heard Benjamin Strong say to Montagu Norman, "Wouldn't it be useful if we could have a chateau in France where the heads of central banks could meet and just talk"? The BIS isn't quite a chateau in France, but it has served that purpose admirably.

Those events of 1929 and 1930 are vivid in my personal memory, for, if you forgive me, I was "present at the creation"—using the name of Dean Acheson's recent book. Let me remind you of what happened—Owen D. Young, who was the chairman of that conference in early 1929 in Paris, when the negotiation for a German settlement was completely stalled, asked four of us to draw up a plan for an international

bank—as a mechanism of reparations transfer. The four included Walter Stewart, advisor to the Governor of the Bank of England; Pierre Quesney, then of the Bank of France and later General Manager of the BIS; Shepherd Morgan, deputy to the Agent General for Reparations Payments; and myself.

The plan that we labored over and drew up in outline did, in fact, help in reaching an agreement on the settlement known as the Young Plan. But, perhaps more important, the Bank for International Settlements, so created, has, over these 40 years, through peace and war, through prosperity and depression, gone on and developed that warmth of personal acquaintance among financial leaders that has been beyond price as a background and stimulus for valuable specific forms of co-operation.

Of course, the next giant step forward was the formation of the International Monetary Fund, and it is very appropriate that Per Jacobsson, who did so much to develop the institution here, should then have moved on to that other second step—the IMF, and that this year the Fund is celebrating its 25th birthday.

So today, against this background, we take a flight into the future under the pilotage of four men who have played roles in recent history which make them suitable guides for the future.

We are enormously grateful to Mr. William McChesney Martin, both for undertaking this assignment and for giving us the chance to read in advance his views on the subject. All of you know him by reputation and most of you know him personally. Your program gives an outline of his distinguished career. While I don't need to repeat that, I would add that he was, in a sense, born a central banker. His father, also my long-term friend, was for many years the able head of the Federal Reserve Bank of St. Louis. So Bill Martin will be viewing his subject today in a long perspective.

It gives me enormous pleasure to ask him to comment on his paper or add to it in any way he sees fit.

TOWARD A WORLD CENTRAL BANK?

by

WILLIAM MCCHESENEY MARTIN

The text of the written paper on this subject which was prepared by Mr. Martin for discussion at Basle begins on Page 13. At the meeting on 14 September, 1970, he introduced his paper and opened the discussion in the oral statement reproduced below.

I am very happy to be here today. I want to start with just a few comments that may be in the nature of reminiscences. Randy Burgess has referred to our long friendship, and I consider him one of my mentors. My respect and admiration for Randy Burgess goes back to the days when I had a copy of his book, "The Reserve Banks and Money Market", alongside my bed every night before I went to sleep. Also, when I needed a couple of sponsors in order to go onto the floor of the New York Stock Exchange, Randy was good enough to be one of my sponsors. It so happened that, on the very first day that I was on the floor of the Exchange, England went off the gold standard. Everybody ran around wildly, asking what would happen now. I went to Randy and asked him how I could learn something about the gold standard. He said to go and listen to E. W. Kemmerer who was giving a course at the time at the New School for Social Research. I did. I listened. I took notes. And I still have a record of everything Professor Kemmerer said. But I am afraid I don't know much more about anything except the technicalities of the gold standard than I did before I started. The fetish, the mystique of gold continues to puzzle me.

The next thing that makes it particularly pleasant for me to be here today is that 23 years ago I came to Basle under the auspices of Maurice Frère, who suggested that I ought to get acquainted with Per Jacobsson. (The recent death of Governor Frère is a great shock to all of us; he had written me that he planned to be with us on this occasion.) I ar-

rived on a Saturday afternoon. It was cold and grey and there was a little drizzle in the air. I didn't know Mr. Jacobsson very well then. He said to me, "Why don't we take a walk?" I agreed, but he was always three steps ahead of me. Meanwhile the rain began to come down a little bit harder; I was getting wetter and wetter, and I had trouble seeing through my glasses. But he paid no attention to the rain. He would say to me ". . . and, you know, what I think the French ought to have done was this, and what the British should do is this." Finally, I reached the point where, with water coming down my glasses, I said, "You know, Mr. Jacobsson, I am enjoying this very much, but if I could just find a dry place where we could sit down I would agree to everything you say."

Because I am in such a mellow and relaxed mood, having retired in February, I can't resist repeating a story that I think gives you, as well as anything I know, a sense of the puckish side of the character of the distinguished economist whom we honor today. He was very pleased with the comment that General MacArthur had made, "Old soldiers never die, they just fade away." When I was privileged to give a little dinner at the Alibi Club in Washington for Per, I had several of the chairmen of the Federal Reserve Banks, three university presidents, and a number of bankers. When the dinner was over, Per jumped up and said, "Now, I am just delighted to meet this group. You know, it is said that old soldiers never die, they just fade away." Then he looked at the university presidents and said, "Old university presidents never die, they just lose their faculties." And then, very pleased with that, of course, he added, "As I look around and see these bankers, I know that old bankers never die, they just lose interest."

One more story from my diary on Per: I played golf with him at the Chevy Chase Club—there are some of you in this room who know the course—and on the third hole we got to talking about inflation. Well, he hit off into the woods on the left and then off into the woods on the right before we finally got onto the green. On the next hole, after his fourth shot almost went into a creek, I said, "Per, I suggest you pick up and let's go on to the next hole." "Oh no," he said, "give me another club." So I gave him another club and he walked down to this little rivulet and took three or four hacks at the ball and then, believe it or not, after carefully weighing his timing he made one more swing and drove the ball right smack into the cup. With that he just looked up,

beamed, and said, "You know, that's the way to do it; if you don't succeed the first time, try, try, and try again."

A lecture in memory of Per Jacobsson seems to be an altogether appropriate occasion to look back on our experiences of international monetary cooperation over the past twenty-five years. It is evident, when we reflect upon it, that the two international institutions with which Per Jacobsson was associated, the International Monetary Fund and the Bank for International Settlements, have already come to perform many of the functions of an emerging world central bank. He contributed a great deal to this evolutionary process by his deeply-felt conviction that international cooperation was workable and by his capacity to communicate to officials in all countries a sense of the international dimensions of whatever current problems they might be discussing. I always thought of him, right up to the time of his death, as Mr. World Central Banker. He was more interested in central banking, it seemed to me, than anyone I was in contact with. It might give you an idea of the interest that he took and the help that he was to me when I say that in 1961 and 1962 I had rather tough going at one point at the Fed and I was thinking seriously of resigning. Someone told him about it, and he took a special trip over to sit down and tell me that really this was no time for me to leave and it was necessary that I stay.

I think that the growing international monetary cooperation that has been centered in the International Monetary Fund and the Bank for International Settlements and the Organization of Economic Cooperation and Development owes a great deal to the dedication of many men. These three institutions have engaged in five main types of activity that would be associated with, in some way, a world central bank: advice to individual countries so that constructive influence is provided from outside for the correction of balance of payments difficulties; multilateral consideration so that proposed national policy actions are examined for their effects on other countries; administration of codes of good behavior accepted and adhered to by sovereign states in the fields of exchange rate practices and of restrictions on trade and capital movements; financial assistance so that countries with external payments difficulties can be provided temporary help; and reserve creation to ensure an orderly growth of official reserves.

When we look at their work as a whole, we can recognize that these institutions have become a force influencing the behavior of individual

nations, through both moral suasion and the provision of credit, creating international money, and attempting to reconcile the conflicting objectives of countries in ways that benefit the international community as a whole. These achievements represent a decisive advance in international cooperation among the countries of the free world. When we think back on the difficulties that we have had in recent years, in the past decade in particular, on both the international and the domestic side, the lessons we have learned from that experience should reinforce our resolution to continue to strive for international cooperation during the 1970s.

Perhaps the most dramatic development to date in the process of evolution toward a world central bank is the agreement to create Special Drawing Rights. Under it, international money is now being created deliberately and systematically and through a process of multilateral decisionmaking. In this aspect, the Fund is serving as a central bank to the monetary authorities of the countries that make up its membership. The SDR mechanism, as presently viewed, does not attempt to lean against the winds of inflation or deflation, but to achieve a relatively steady rate of growth of world reserves. It can help to provide a basic and steady environment for noninflationary growth of the world economy, leaving to other forces the function of financial stabilization. But we can also look ahead to see that the stabilization function could be added to the SDR mechanism. The Fund could try to promote stabilization through somewhat greater variation in the rate of growth of world reserves over time as a means of offsetting cyclical tendencies in the world economy.

The activation of the Special Drawing Rights has important implications for the policies of the United States and of our trading partners. In the future, the U.S. balance of payments should no longer be, as it has been in the past, a major source of growth in world reserves. The United States will have to keep its external payments more-or-less in balance in the decade of the 1970s. This means that, among other things, the United States will have to aim at a more effective domestic stabilization effort than we were able to achieve over the past few years. On the other hand, however effective our performance, we can achieve this balance of payments goal in an interdependent world only if other major trading countries adopt reasonable balance of payments objectives and then take effective measures to attain them. During the decade ahead, the world economy can profit from the advance in orderly growth

represented by the Special Drawing Rights mechanism only if the major industrial countries can find ways to eliminate the large and continuing deficits and surpluses which were recorded during the 1960s.

I want to comment here as to why I think the Special Drawing Rights were essential and necessary, and I am glad that Secretary Fowler was able to come to this meeting this afternoon because he played such an outstanding role in making them possible. There were two problems, it seems to me, in the economic disturbances in the 1960s in the payments mechanism. One was very poor policies. I don't have to elaborate on that; when we have poor policies, the end result becomes apparent over time. The other was a growing fear that there would not be adequate reserves to deal with the rapid growth in world trade. This at first seemed to me not too legitimate a worry, but as time went on it seemed to me that it was a bona fide worry. In the U. S. Treasury and in the Federal Reserve and at the International Monetary Fund and elsewhere people began to make studies of world reserves. Our statistics are not very accurate on these things and people have different judgments, but it began to become apparent to me that we were in trouble. In the five years from the end of 1964 through 1969 the growth of world reserves was about one per cent per year. And most of that growth was the result of credits extended by the Fund and by monetary authorities. In the period from 1951 to 1965, it was about 2½ per cent, 5 per cent outside of the United States.

Here I want to say something that is self-serving in one sense, namely, that we ought to remember the contribution that the United States made through the Marshall Plan to the reserves of the world. I was in the Treasury during that period, and there was a lot of criticism in Congress of the fact that some of the aid was going into foreign reserves. The United States did not protest that. Rather, the United States deliberately created a deficit in its balance of payments in order to help other countries replenish their reserves. Now we are through with the Marshall Plan, and I am not trying to exaggerate its effects or to downplay in any way the European contribution to economic recovery. I merely want to point out that both the United States and Europe became adjusted to a U. S. balance of payments deficit in those days.

When it became apparent that there was a slowdown in reserves, we did lay to rest the belief that the only way to handle this problem was to

increase the price of gold. We made it clear that it was possible to add to the reserves of the world in an orderly, systematic way and after a deliberate, conscientious study.

I remember, incidentally, that there were some Americans who thought, in the early postwar years, that, if an increase in the price of gold was in the cards, that was the time to do it—when U. S. gold holdings were around \$25 billion. I am glad to say that we did not follow such a course and now, with SDRs, it need no longer be considered.

Now, this SDR scheme has laid a responsibility on the United States to make good by holding down its balance of payments deficit. If they don't make good on it, we are going to be in a chaotic condition again. I don't want to see the world on a dollar standard, but I am convinced that the two-tier gold system, though not perfect, and the provisions that have recently been made for the orderly marketing of gold, make it possible for us to have gold as a commodity and gold as a monetary asset. Never has there been the slightest intention on the part of the people that I have worked with to demonetize gold, or to eliminate gold from the picture. The desire has only been to achieve a settlement, a reasonable settlement, that could provide, in an orderly and an intelligent way, a reconciliation between the monetary and commodity uses of gold without downgrading or trying to displace gold as a monetary unit. For the foreseeable future, gold will be the major part of the U. S. reserves. If the United States puts its balance of payments in order (and whether it should be zero or near zero on the official settlements basis or not is not an important matter at the moment), the SDR and the two-tier system give us the means of keeping the gold exchange standard functioning without chaos.

I want to make some comments on the inflation problem, because I think it is still the biggest problem. We are beset by inflation. Today, we are seeing around the world a wage explosion of major force. Nobody was more conscious of this problem and of the necessity of dealing with it than Per Jacobsson. There are two schools of thought that have developed since the full employment concept was accepted generally by governments. One school was that you can only have high levels of employment with inflation; that there is a trade-off between unemployment and inflation. The other school of thought—to which I happen to belong, and, while they aren't here to defend themselves, I think that

both Per Jacobsson and Lord Keynes would also be in that school—is that it is not possible to have high levels of employment on a semi-permanent basis with inflation. Inflation disrupts and undermines and dislocates in such a way that whatever employment is created by it is only temporary. Therefore, if we do not find means of resisting this inflation and keeping it under control, we are not ever going to attain the full employment goal that all of us are striving for. I state this as my conviction. And this is where the restraining conscience of a central bank comes in. There are many instances where budgetary policy has been overly expansive, where debt management policy has been anything but conservative, and where wage-cost-price policy has been in a virtually explosive state. Under those conditions the only thing left is monetary policy. The central bank could, of course, grind the machine to a halt, but that would be no service. It certainly can, however, be a restraining conscience. I think it is important that the central banks of the world keep this problem in front of us. I believe that, over a long enough period of time, we will demonstrate that the only real possibility of having semi-permanent high levels of employment is to have relative stability in prices and to resist these inflationary trends. If we are to do this, central banks must retain their independence within the government, but not be outside the government. They must work side by side with the government. What we need to have is central bank chiefs who stand high in the counsels of their respective governments and yet are independent of the political power of that government, men not completely autonomous but independent in the sense that, even as they are working side by side with their government leaders, they can under certain circumstances say we will, as a matter of conscience, go this far and no further, and the government perforce must listen.

Now where do we go from here in this emerging world central bank atmosphere? I think that there are a number of things that could be considered. I have listed here consolidation of the several reserve assets now in use into a single asset; we should continue to study this idea. Multilateral supervision of the Euro-currency and Euro-bond markets? They are totally unregulated today and it seems to me that in the interest of everybody there should be some supervision and regulation of those markets. Greater harmonization of monetary and fiscal policies among countries in general, and among regional groupings, such as the European communities in particular, could also be of universal benefit.

When it comes to organization, I don't think it is terribly important whether we can agree today upon the institutional outlines of an ideal central bank. I think, on the contrary, that what we need is a willingness on the part of nations to accept the economic and monetary constraints of our interdependent world economy. If we remain committed to international cooperation, we will be able to work out the procedures for carrying it out and assuring its proper evolution. *I have long felt that there should be a federal reserve system in Europe and I think that some day it will come.* I think that eventually you will see groupings around the world in one form or another, and that probably there will be some umbrella, whether it is the Monetary Fund or whatever.

I think we have come a long way in international cooperation in financial affairs in the past generation. When I think of the objections that I heard a number of years ago to the thought of a world central bank or to the type of international cooperation that has developed, it amazes me. A general acceptance has come about, and it seems to me that we are not being overly optimistic to believe that we can go forward. How long this will take, or how much give and take will be required, I am not endeavoring to say. I think that the step from the Fund's Articles of Agreement in 1945 to the ratification of the Special Drawing Rights mechanism in 1969 is an historic one. Because of these gains we certainly have a right to be optimistic that we can make further progress toward a world central banking function during the 1970s.

I started my prepared paper by pointing out that central banking is a relatively modern art. I worked through all the texts on central banking, Kisch and Elkin, Hawtrey, DeKock, Beckhart, Willis, Robertson, and all the rest of them, and I decided that I would stick with the word "art." Central banking is a relatively modern art, even when you remember that Governor Asbrink invited us to Stockholm to celebrate the 300th anniversary of the Swedish National Bank, that the Bank of England began in 1694, the Bank of France in 1800, and the Reichsbank, if I am correct, in 1875. They are very modern, and when you come to the Federal Reserve System in 1913 and the Bank of Canada in 1935, you realize how modern the art is. The art of central banking, in my judgment, has become one of the keystones in the arch of our civilization and, like money, and the use of money, it is constantly evolving out of the wellsprings of human needs. In the world we are living in today there can be little question that it will be very desirable,

helpful, and important to have a strong world central bank to act as the restraining conscience that I am talking about on a multilateral basis. Some of this is being done now in the Fund, some of it is being done in the BIS, some of it is being done in the OECD. Perhaps all of these activities will be brought together in some form some day. I know most of the objections that can be raised to the concept of a world central bank—that it is visionary or impossible of achievement. I also know the value of having different views and independent actions by differing countries and the desirability of decentralization. I have heard all of these arguments. Nevertheless I believe that we are on an inevitable course that will lead us to some cooperative form of world central bank.

I had a special section on sovereignty, and this is a particularly interesting one because we all know the old-fashioned concept of sovereignty. I think we are going to have to pool some of our sovereignty if we are going to make this interdependent world work. Peace in the world today is no longer an option. It is imperative for our survival. All I want to say in conclusion is that, if we continue along the course we are on, the probability of having peace will definitely be enhanced and that unless we have political stability we won't have peace.

* * * *

W. Randolph Burgess:

We are doubly grateful to you, Mr. Martin, not only for giving us your carefully reasoned written text, but even more for exposing to us your emotional dedication to some of these causes that are discussed in that document. What you have written and now underlined orally is a great contribution to us here and more broadly around the world to everybody who reads the Proceedings of this meeting.

Now, we are very fortunate in having a trio of commentators representing different fields and points of view—a man who has been the dean of European central bankers; a leader in the central banks of Latin America; and a leader in the academic field on this subject. I have particular pleasure in turning to the discussion stage of our meeting and calling upon Dr. Karl Blessing who started his career as a central banker fifty years ago. He has made an enormous contribution to central banking, both in the Bundesbank in his own country, through the BIS, and elsewhere.

TOWARD A WORLD CENTRAL BANK?

by

WILLIAM MCCHESENEY MARTIN

The text of Mr. Martin's written paper on this subject was distributed in advance to those attending the lecture meeting. It is reproduced below. His oral presentation of this paper is given on the preceding pages 4 to 12.

“Life cannot subsist in society
but by reciprocal concessions.”

SAMUEL JOHNSON

Central banking is a relatively modern art which has become one of the keystones in the arch of our civilization. Like money, and the use of money, it is constantly evolving out of the wellsprings of human need. In the world of today, a strong world central bank is becoming more and more essential to support orderly economic growth in a constructive international context.

My purpose in this lecture is twofold: (1) to spell out and substantiate the thesis that some of the functions of a world central bank are already being performed, and (2) to examine some of the ways in which further evolution toward a world central bank may occur.

Economic cooperation among nations, and especially monetary cooperation, has made enormous strides in the past generation. If we examine what such growing international cooperation means, we shall see that it may be characterized as evolution toward a world central bank. Where this evolution will ultimately lead—particularly in terms of specific institutional development—is not a question that I shall try to answer today.

The 1930's demonstrated all too well the dangers of economic nationalism and taught the lesson of economic interdependence—that each nation's prosperity depends upon the prosperity of its neighbors. We learned this lesson from bitter experience, involving competitive depreciation and other beggar-your-neighbor policies with which nations attempted to rid themselves of their own ills by exporting them to their trade partners.

Thus it has become widely accepted that nations can prosper only if they prosper together. And to prosper together, nations must act together to create an economic environment conducive to their mutual welfare.

No community can thrive without some constraints on the behavior of its members. To prosper together nations must accept some limitations on their freedom of action. Acceptance of such constraints springs from enlightened self-interest: from the awareness that, in an interdependent world, nations must take account of the feedback of their own behavior, since this behavior affects the actions of others.

It is the awareness of this interdependence and the willingness of nations to permit it to influence their policies that constitute the basis of international economic cooperation. Implementation of such cooperative behavior is, of course, centered in the international institutions that have become so prominent in the past generation: the International Monetary Fund, the Organization for Economic Cooperation and Development, and the Bank for International Settlements.

The role and influence of the International Monetary Fund have become increasingly evident. It is appropriate for us to note that during the incumbency of Per Jacobsson as Managing Director, the Fund's activities increased markedly. The various bodies of the OECD have also blossomed in the past decade as forums for the implementation of international cooperation. And with the advent of currency convertibility in Europe and Japan and the creation of inter-central bank credit arrangements designed to help prevent disorder in foreign exchange markets, the BIS has achieved much greater prominence in recent years.

If we ask ourselves what these international bodies accomplish, we shall see that they perform what are essentially world central banking functions. The interests of the world community as a whole are brought

to bear on the policies of individual nations. If the influence is successful—and I don't suggest that it always is—national policies will reflect it and nations will act differently from the way they otherwise would have acted. International cooperation exerts an influence on different parts of the world economy in order to reconcile divergent tendencies and improve the well-being of the whole.

The international institutions to which I have referred have been engaged in five main types of activity:

- (1) giving advice to particular countries with balance of payments problems (whether of the deficit or surplus kind) with a view to aiding in the solution of those problems; this almost invariably involves consideration of the fiscal and monetary policies of the country under consideration;
- (2) framing such policy advice on a basis that would produce optimum results, not only for the particular country whose problems were under review but for other countries that would be affected by the correction of the problems; in the process, the representatives of member countries find themselves viewing and explaining their own objectives against the objectives of other countries;
- (3) administering internationally-accepted codes of behavior regarding exchange practices, balance of payments restrictions (and, in the case of the General Agreement on Tariffs and Trade, trade practices);
- (4) providing financial assistance to help countries ride out periods of payments difficulty; and,
- (5) providing means to assure the necessary growth of official reserves.

Let me now give some specific examples of the ways in which the functions that might be performed by a world central bank have been performed, at least in part, by existing institutions.

I. M. F.

The International Monetary Fund is the international institution with the widest membership and with the clearest potential for evolution

toward a world central bank. Even before the SDR amendment to the Articles of Agreement, the Fund was performing a central banking function. It was exercising an influence over the economic policies of its member nations, in part a complement to its lending to them and in part independently of its lending.

Members of the Fund that draw on their credit tranches are required to meet certain policy standards laid down by the Fund. These standards are adapted to the problem of the particular country in balance of payments difficulty and in need of external credit. Of course, any bank is likely to look to the future performance of its borrowers if only to safeguard the quality of its assets. But the Fund clearly has a purpose beyond normal banking prudence. The Fund encourages a borrowing member to adopt policies that will correct its balance of payments problem not by any means available but in ways that are compatible with achievement of the economic objectives of other countries as well. This often, indeed usually, involves focusing attention on the inflationary potential, domestically and internationally, of economic developments in individual countries. Thus the Fund represents the interests of the entire community when it uses its power to extend credit as a level to influence the policies of its individual members.

It is noteworthy that the Fund exerts an influence on the policies and practices of its members quite apart from occasions when its members are seeking to borrow from it. The Fund is charged with enforcing the Articles of Agreement, which impose specific obligations on members. But, beyond this, and also beyond the consultations that members countries are required to hold with the Fund when they maintain exchange restrictions, the practice of annual consultations has developed between the Fund and its members even when not required by the Articles.

Here we have an example of the Fund acting in behalf of the international community as a whole as it reviews the past and prospective policies of its members and passes judgment on them on the basis of their contribution to the achievement of the purposes of the Fund—which express the shared economic and financial objectives of the entire Fund membership.

The Fund's influence over the larger, industrialized countries has been strengthened by the development of two-way relationships between

the Fund as a whole and a group of its larger members known as the Group of Ten. These countries, acting together, have not only served as a supplemental source of resources when the IMF faced needs for funds in meeting the drawings of major countries, but it has also served as a forum within which a consensus could be reached among these leading countries on some issues of broader importance for the Fund as a whole—issues which required the support of the major countries if the objectives of the IMF were to be fulfilled effectively.

It is clear that the various avenues by which the Fund influences the policies of its members place the Fund in the position of exercising a central banking function—that of influencing the parts to improve the well-being of the whole.

O. E. C. D.

A similar function is performed elsewhere. The past decade has brought a considerable development of consultation processes in the Organization for Economic Cooperation and Development. The Economic Policy Committee and Working Party Three of that organization have been the forums for close consultations among senior officials of treasuries, central banks, and economic ministries about the economic and financial policies of the industrialized countries. I know from personal experience and from the reports of my former associates at the Federal Reserve Board that economic cooperation has made marked advances as the result of these consultations.

Striking examples could be cited of ways in which individual countries' policies have been shaped as a result of examination and discussion in these forums. It has been applied to countries that were experiencing recession and to those experiencing inflation, to countries in chronic surplus as well as those in chronic deficit. In all cases the purpose is to improve the performance of the individual country in ways that will also serve the well-being of others.

A related function performed by these bodies of the OECD is to examine the policy objectives of the member countries for compatibility with each other and with the welfare of the rest of the world. Given the high degree of interdependence that prevails, no nation can expect to achieve its policy objectives without due regard to the actions of

its neighbors and trade partners. This applies to objectives regarding economic growth, price stability, the structure of the balance of payments, gains in reserves, and still others. To test the consistency of such objectives—both from the national and international viewpoint—is a useful and significant function, one that exemplifies vividly the advancement of the degree of economic cooperation and the way in which such cooperation, by influencing countries to modify their policies so as to make them more consistent with the pursuit of the welfare of the entire community, begins to resemble one of the functions of a world central bank.

B. I. S.

Another example of the processes I have been discussing is provided by the consultations and cooperation arrangements that are associated with the regular meetings of central bank governors here at the Bank for International Settlements. Again there is a dual process: on the one hand, the examination of individual countries and, where problems exist, an effort to influence policies so as to bring them more into harmony with the well-being of others; on the other hand, the development and operation of multilateral financial arrangements that benefit the entire group. Under this latter heading come the vitally important reciprocal credit facilities—so called swap lines—among central banks, through which some \$33 billion of short-term credit has been extended and repaid over the past eight years; along with the special arrangements to stabilize sterling balances and occasional credit packages to assist an individual country in its stabilization efforts. These examples of successful cooperation among central banks provide further substantiation of my thesis that we have witnessed in recent years a growing awareness of interdependence and a willingness to act in ways that benefit the community as a whole.

I might note at this point that the man whose memory we honor, Per Jacobson, was intimately associated with two of the institutions I have just been discussing. Although Per Jacobson expressed doubts about the wisdom and practicality of a common currency in advance of common government, he was a strong believer in the benefits of international cooperation. I would like to think that he would support much of the thesis I am putting before you today.

Special Drawing Rights

I move on now to speak about the most dramatic development to date in the process of evolution toward a world central bank. This is the agreement to create Special Drawing Rights.

The SDR mechanism provides a direct and clear-cut central banking function and on a basis as world-wide as the membership of the International Monetary Fund. International money is now being created deliberately and systematically and as the result of multilateral decision. Such international money, created by the Fund, constitutes official reserve assets for those who hold it. In this respect, therefore, the Fund is serving directly as a central bank to the monetary authorities of the countries that make up this membership.

The Fund evolved toward this function gradually. For many years “reserve positions in the Fund”—that is, gold tranche and super-gold tranche positions—were usable by members virtually on an automatic basis and came to be regarded as a part of official reserves. Thus, even before SDRs came into existence at the beginning of this year, a claim on the Fund served as international money.

The further evolution that occurred this year, after several years of study and negotiations, had to do with the manner in which such international money comes to be created. Reserve positions in the Fund are brought into existence in two ways. The first is the result of gold payments to the Fund by members whose quotas are being increased; in this case, members simply exchanged one reserve asset—gold—for another—gold tranche positions. The second is the result of the use of a member’s currency in drawings on the Fund by other members; in this case, new reserves are created as the counterpart and by-product of IMF lending operations. The extent to which gold and super-gold tranche positions come into existence, in this second case, depends on the extent to which members use their credit tranches—that is the extent to which they borrow from the Fund. Thus the Fund itself has no direct control over the magnitude of reserve creation.

The big step forward under SDRs is that reserve creation in the Fund became a deliberate, conscious process. The decision as to how to create is made on the basis of a careful judgement as to the need

for reserves by the world community and on the basis of a recognition that world payments equilibrium requires an adequately-growing supply of reserves.

The evolution I have just described—whereby international money creation in the Fund as a by-product of Fund lending operations has been supplemented by a deliberate and direct process—is remarkably analogous to the historical evolution that occurred in the money creation process within individual countries. Even before central banks existed, commercial banks were, of course, creating money as a counterpart to their lending activities. But the extent of money creation was the uncontrolled result of the extent of bank lending. It was only with the development of central banking in all our countries that the rate of expansion of bank credit and money came to be deliberately regulated in the public interest.

* * *

I have tried to spell out the various ways in which growing international cooperation can be thought of as performing the functions of a world central bank. To summarize, these functions are to make the behavior of the parts compatible with and conducive to the welfare of the whole—by influencing the behavior of individual nations through both moral suasion and the provision of credit, and by creating international money in an amount sufficient to satisfy what would otherwise be the incompatible objectives of individual units with regard to the accumulation of reserves.

The Problem of Sovereignty

The progress I have been describing originated between and has been accepted and welcomed by sovereign states. One often hears it said that the existence of a world central bank is inconsistent with the maintenance of national sovereignty. So it is, if by sovereignty one means what has traditionally been implied by that phrase—the unfettered right of national governments to act in whatever way they may choose in economic financial, or defense matters. But I do not believe that it is helpful to use this conception of sovereignty even as a point of departure. For what we have been witnessing has been a willingness of nations, by the exercise of their sovereign rights, to recognize that the national interest

can no longer be pursued in isolation but is dependent on cooperative action in deference to the common good. It has become more and more clear that this involves no loss of sovereignty but rather a pooling of sovereignty. It could even be said that what were once the principal objectives of sovereign powers—the maintenance of economic prosperity and of effective defense—can now only be achieved by the acceptance of cooperative international arrangements which by their very nature impose limitations on the sovereignty of all the nations concerned. The increasingly clear recognition of this new reality in international affairs has alone made possible the developments that I have been describing. Further evolution along the path toward a world central bank will require nations to accept further limitations on their freedom of independent action, in their own and others' interest.

The very fact that, at its present stage of evolution, the international monetary system is made up of nations that still retain a substantial measure of their traditional sovereign powers means that the world central banking function has a special responsibility that normally does not trouble the central bank of an individual country. Within a country, payments equilibrium among its various regions comes about more or less automatically. While many of our nations have been faced with regional economic problems, we do not regard these as being primarily balance of payments problems. But, internationally, a system of sovereign states is, as we all know, subject to payments imbalances that can create instability and disruption. Thus a world central bank would have this additional function—to facilitate the adjustment process and promote this additional function—to facilitate the adjustment process and promote payments equilibrium.

Exchange Rate Flexibility

In the past year, the Fund has been undertaking a study of limited exchange rate flexibility as one means of improving the balance of payments adjustment process. I am confident that no changes in exchange rate practices will develop out of this effort that would be inconsistent with—or would weaken—the international cooperation that we are considering today. The Executive Directors have presented a preliminary report to the Governors on this whole subject which has just been made public and which will be on the agenda of the Copenhagen meeting.

Where Do We Go From Here?

We may now ask ourselves about the prospects for further development along the lines I have been sketching. What is the potential and what are the prospects of the evolution toward a world central bank?

Perhaps the best way to pursue this question is to consider the functions of a full-fledged central bank and to ask, in each case, whether and how the function could be performed in an international setting.

Money-Creating Function

Let us begin with the money-creating function of a central bank. We have already taken note of the SDR mechanism and observed that the International Monetary Fund is now in the business of creating international money—official reserves—on a regular and systematic basis. Perhaps we can view the IMF not merely as a creator of one type of international reserve asset but also as a regulator of the total volume of reserves.

Clearly the Fund is not the only source of new reserve assets. Some newly-mined gold may come into monetary reserves under the two-tier system, though the amounts are not expected to be large. Reserve assets can be created as the result of inter-central bank loans. And, as we all know, expansion in the officially-held liabilities of reserve currency countries (whether or not an official settlements deficit exists) adds to world reserves.

No doubt the Fund will take account of the prospective magnitude of these other forms of reserve creation in deciding on how much of SDRs to create in each basic period. In that sense, the Fund becomes a regulator of the volume of total world reserves. Beyond that, the Fund will continue to exert influence upon the behavior of reserve-creating countries.

U. S. Balance of Payments

In this connection, I must digress briefly to say a few words about the U. S. balance of payments, since this has been a major generator of

world reserves in the past. It is my conviction that in adhering to—and in fact, taking the leadership in promoting—the SDR program, the United States was accepting the proposition that its balance of payments should not in the future be a major source of growth in world reserves. This proposition has several corollaries:

1. The United States must make every effort to keep its payments position more or less in balance. Whether this requires a zero deficit on the official settlements basis need not detain us now. And certainly we have to expect swings from one period to another. But the main point is that the United States must have, along with its domestic economic objectives, a balance of payments goal and a set of policies to achieve it.
2. Such a goal is achievable only if other countries also adopt reasonable balance of payments goals and take actions to attain them. In particular, if other countries do not take measures, including exchange rate adjustment where appropriate, to prevent persistent surpluses, the United States is unlikely to avoid deficits in its external accounts. To state this principle is in no way to relieve the United States of responsibility to adopt appropriate domestic and balance of payments policies—and particularly to prevent inflation. Proper policies on the part of the United States are a necessary but not a sufficient condition for the maintenance of equilibrium in the U. S. balance of payments.
3. There is another related condition for U. S. payments equilibrium. The amount of SDR creation must, while carefully limited, still be adequate to meet the need for growth in world reserves. If it is not, other countries may well follow policies to increase their reserve holdings of dollars, and these policies would make a deficit in U. S. payments almost inevitable no matter how well the United States manages its policies. I believe that this principle has been widely accepted, subtle and subject to misinterpretation though it may be. It is subject to misinterpretation because, on the surface, it appears as an excuse for the persistence of a U. S. deficit. It is subtle because an adequate volume of SDR creation does not assure proper U. S. policies; but, on the other hand, proper U. S. policies will not result in payments equilibrium without an adequate growth of world reserves.

SDR Mechanism - A Regulator

Returning now to my main theme, we may regard the SDR mechanism in the Fund as a regulator, imprecise though it may be, of the growth of world reserves. This is truly a world central banking function—as distinct from the quite different task performed by the United States when it was the principal source of additions to world reserves.

As presently viewed, this central banking function of the Fund aims at a relatively steady rate of growth of world reserves. The SDR mechanism does not attempt, in the short run, to lean against the winds of inflation or deflation. Rather, it provides a basic and steady environment for non-inflationary growth of the world economy, leaving to other forces the function of stabilization.

Stabilization

Thus another path for further evolution, as we try to peer into the future, may be the addition of a stabilization function to the SDR mechanism. I believe it is accurate to say that the Fund does not perform this function now except by influencing the policies of individual countries. Presumably one way in which the Fund could try to promote stabilization would be to bring about somewhat greater variation in the rate of growth of world reserves over a period of time as a means of offsetting cyclical tendencies in the world economy. I do not wish to overemphasize this potential extension of the Fund's functions as a world central bank. It may well be that changes in the rate of growth of world reserves would have only minor short-run effects on national policies and therefore on world demand. But this is one possible path of further evolution.

Central Banks Serve as a Restraining Conscience

Whether or not the SDR mechanism is adapted to serve short-run stabilization purposes, one should expect the evolving world central banking function to be concerned with stabilization. Traditionally, central banks serve as a restraining conscience on governments which may be tempted to over-expand and to generate inflation. Such a conscience

is needed on the international plane, too. I cannot emphasize this point too strongly because, in my judgment, this is a crucial contribution that central banks can make.

Consolidation of Reserve Assets

We may take note also of the proposals that have been put forward for the consolidation of the several types of reserve assets into a single asset. Without going into the details or the implications of these proposals, we may observe that they fit in naturally with the evolution toward a world central bank. At some stage in that evolutionary process, it might be appropriate to consider whether greater international monetary stability would be promoted by a move toward a single reserve asset on the books of the Fund. In this plan, the members of the Fund would turn in their holdings of gold and reserve currencies, aside from transactions balances, and would receive in return a claim on the Fund similar to the SDR.

Other Central Banking Functions

Another central bank function—that of the lender of last resort—may be said already to be performed by the International Monetary Fund. We have seen in recent years a sizable expansion in Fund drawings by both industrialized and developing countries when in payments deficit. And, over the years, the capacity of the Fund to meet these has grown, as quotas have been increased.

Apart from their lending and money-creating activities, central banks are often concerned with regulating financial institutions and financial behavior. Once again, a counterpart already exists in the International Monetary Fund, which is charged by the Articles of Agreement with administering the par value system and promoting exchange practices that are conducive to the economic welfare of the world community. The current discussions about limited flexibility of exchange rates are properly centered in the Fund and are entirely consistent with the view of the Fund that I have been putting forward.

Eurocurrency and Eurobond Markets

Another aspect of the regulation of international financial behavior relates to the great international money and capital markets—the so-called Eurocurrency and Eurobond markets—that have developed so dramatically in recent years. At present there is little, if any, multilateral supervision of these markets. One need raise no doubts about the soundness of the claims that are created and exchanged in these markets to suggest that a case can be made for giving to an international institution some responsibility for supervising these markets. This too would be a natural development in the evolutionary process we are discussing.

Multinational Corporation

A striking aspect of economic events since World War II has been the burgeoning of the multinational corporation. We are all trying to understand and foresee the many implications of this development. Of one thing I am sure: the basic forces that are leading to the startling growth of multinational corporations also point in the direction of ever-closer cooperation among monetary authorities—that is, toward a world central bank.

Harmonization

Finally, I come to the special problem that faces a *world* central bank—trying to promote harmonization of the policies of the member states and maintenance of payments equilibrium among them. We have seen that progress has been made in this area, and that a number of international institutions have been involved. A particular effort toward harmonization is presently being made in the European Economic Community. And there is every reason to expect similar efforts elsewhere. But this raises an intriguing and delicate organizational question.

We have observed that the evolution to a world central banking function takes many forms and occurs not only in the Fund but in other international bodies also. It may turn out that the world central bank of the future will have a federal-type organization. Not all its activities need be centralized. Thus one can imagine various types of regional groupings of countries, geographical or according to stage of develop-

ment, or both, for each of which certain central banking functions might be performed by a separate unit. I believe, however, that international monetary cooperation has benefited from avoidance of the proliferation of international bodies that has characterized other international fields.

It is germane to ask whether or not we should hope to see, over the years, a more coordinated approach organizationally. Should we envisage that, instead of a dispersal of functions among the several bodies I have referred to, there would in time be a gradual incorporation of these activities under the umbrella of the International Monetary Fund? To state this issue even tentatively is to raise a host of questions. I have no reason, or means, to try to answer these questions now.

But if I am correct in discerning that we are in a process of evolution toward a world central bank, we must expect, at some stage in the future, to see somewhat greater organizational coherence in the exercise of the world central banking function.

The evolution we have been considering today is, of course, only one aspect of the growing interdependence of nations. It is quite proper that a Per Jacobsson lecture should focus on economic and, more particularly, monetary interdependence. We all know, and no one knew it better than Per Jacobsson, that in today's world peace among the major powers is no longer an option. It is an imperative for survival.

Let me close by asserting my conviction that further evolution along the lines we have been examining today will enhance world political stability and with it the probability of peace.

COMMENTARIES

Following Mr. Martin's oral presentation of his paper, the President of the Foundation called upon the members of the panel for their comments.

Dr. Karl Blessing:

My distinguished friend, William McChesney Martin's splendid and comprehensive lecture has made it rather difficult for me to add very much on today's topic. He has very clearly pointed out what has been achieved in the past, he has explained that some of the functions of a world central bank are already being performed, and he has examined ways and means in which further evolution may occur. I agree to a very large extent with what he has said, and yet I cannot help feeling that he has painted rather too rosy a picture.

It is entirely true that tremendous progress has been made both in central bank cooperation and in the activities of the BIS, and I also subscribe fully to what Mr. Martin has said about the IMF and the OECD. I would even go so far as to say that without this international cooperation the international monetary system would already have collapsed years ago. Nobody can deny that the present system has periodically run into crises, but equally nobody can deny that a lot has been achieved since the war. World trade has expanded faster than ever before, a high level of employment has been maintained, standards of living have improved considerably and international cooperation has always managed, in the end, to cope with the crises that have affected different currencies.

We cannot, however, close our eyes to the fact that, despite the high level of international cooperation and despite the many devices devel-

oped in the last few years, the international monetary system is not in good shape. It is certainly true that nowadays nations recognize much more clearly than before that their national interests can no longer be pursued in isolation. But, when it comes to adjusting their economic and monetary policies to the outside world, they sometimes take a different attitude. Their domestic political situation often prevents them from taking corrective measures.

We all know only too well the deficiencies of the present international monetary situation: balance of payments disequilibria and worldwide inflation. Part of those disequilibria has been removed lately by the British and French devaluations, together with the corrective measures taken in those countries, and by the German revaluation. But inflation is still going on and has even accelerated, and the U. S. balance of payments problem is still unsolved. The risks and uncertainties of the gold exchange standard, which has more and more become a dollar standard, still exist. The forces creating balance of payments disequilibria are still at work, price and cost disparities may re-emerge at any time, and the working of the adjustment process remains unsatisfactory.

International cooperation and the activities of the international monetary institutions could not prevent those deficiencies, and even a full-fledged world central bank could only do away with them if it had full power to compel national authorities to abandon inflationary policies and to apply a better balance of payments discipline. In spite of the willingness of nations to cooperate, there are still conflicting national interests and different targets aimed at by different governments. Some governments put more emphasis on full employment and growth, others on price stability. If countries were to comply with the unwritten rules of the gold standard, that is to say, if all countries were to exercise the same measure of monetary discipline as they did under the gold standard, it might perhaps be possible to do away with the monetary troubles of our time and to make more progress towards a world central bank. Since the great crisis of the thirties, and after Keynes and the revolution he produced in the minds of the economists, countries now have a different philosophy from that which prevailed under the gold standard. They wish to manage their economies much more with a view to maintaining high employment and high rates of growth, or what they regard as such, than with a view to maintaining price stability and strict order in their balances of payments. Governments nowadays are always ready

to resort to deficit spending even in a period of very mild stagnation or recession but they always refuse to apply vigorous fiscal policies in a boom period. The result is that prices go up from cycle to cycle. The worldwide creeping inflation that has prevailed for many years now is to a large extent the result of the philosophy that developed in the thirties and the practical behavior deriving from it after the war.

Without a fundamental change in philosophy and behavior there is not much hope either of improving the international monetary situation or of making more progress towards a world central bank. In theory, one might imagine a world central bank being established or the IMF being transformed into such a bank, in order to enforce better monetary discipline. But this could only be done if national freedom of action and national sovereignty were restricted to an extent which, in my opinion, would not be accepted by national governments and parliaments, at any rate not in the present state of affairs.

Let me now ask the question: what the task of a world central bank would be if one day it were to be established? The proposals for creating a world central bank or for transforming the IMF into such a bank usually rest upon an analogy drawn between a national central bank and a world central bank. The task of a national central bank is to manage monetary and credit policies, to supervise the domestic banking system, and to act as a lender of last resort; in other words, to manage the domestic money supply with a view to maintaining economic activity and at the same time to defending the internal and external value of the currency. Those who advocate a world central bank obviously think that such a bank would do for member countries and their central banks what each national central bank now does for its own country and its own banking system. A world central bank would therefore have to manage the international monetary system and the international money supply. It would operate as a lender of last resort for national central banks, if they were in need of foreign exchange to cover a balance of payments deficit.

In doing so it would have to apply very strict lending rules and it would have to exercise a strong influence on the economic and financial behavior of the borrowing countries. Otherwise, the borrowing countries might fail to repay their debts later on because they did not achieve a balance of payments surplus. The influence of a world central bank

would certainly have to be far greater than the influence now exercised by the IMF when countries are drawing on the credit tranches. In fact it would have to lay much greater emphasis on price stability. Its lending rules would have to take into account the experience of the postwar period when the danger of excess demand and inflation was far greater than that of recession and unemployment. To reach international agreement on this issue would probably not be easy. But even if it were possible to agree on strict lending rules, the managing board of the world central bank would be put in a difficult position. Could or would the managing board cease to grant credits to a member country if its recommendations for corrective action were neglected for one reason or another? The experience of the Fund shows how difficult it is to bring countries to take corrective measures. Could a world central bank achieve more than the Fund? And what would happen if the managing board came to the conclusion that the exchange rate of a certain currency was no longer realistic? The Fund has no power to propose a change in parity. If a world central bank were given this power, would its advice be followed?

One cannot neglect the fact that there are considerable differences between the operations of a national central bank and a world central bank. A national central bank operates within the sovereign authority of only one government. Even if it is independent it has to support the financial and economic policies of its government. A world central bank would operate as a creature of many sovereign governments. Its managing board would often hold views about the appropriate economic and financial policies in a particular country that were different from the views of the central bank and the government of the country concerned. Therefore, member countries' power to act on their own would have to be curtailed. Of course, even now a country has to take into account the repercussions of its actions on other countries. But there is a considerable difference between a country adjusting individually on its own initiative to the outside world and a country adjusting on the recommendation of, or under pressures from, an international body. One might argue that the object of creating a world central bank is precisely to end the sovereign right of individual countries to expand their domestic money supply excessively and to permit inflationary developments. But the national political difficulties involved here are tremendous.

Even in the Common Market, where a firm political desire to integrate exists, it is extremely difficult to coordinate and harmonize the different trends in member countries as regards total demand, prices and balances of payments. A monetary union of the Common Market countries as the ultimate aim can only be achieved if the member governments pool a great part of their sovereignty in some form of central authority. The customs union which has already been achieved is not sufficient for the attainment of that aim. Without a far-reaching coordination and harmonization in the economic, financial and credit fields no progress towards such a monetary union can be made. Of course, in theory one could establish a kind of Federal Reserve Bank of Europe right now, with full power to enforce integration and coordination as it is sometimes suggested. But such a procedure would involve too much political dynamite. It would probably not speed up the integration process and might even blow it up. It has therefore been agreed to proceed in stages by doing away step by step with national divergencies in the economic, financial and credit fields. It is obvious, for instance, that deficits and surpluses in the national public budgets and the manner in which they are financed influence the monetary situation of the whole community and cannot be left entirely to the discretion of member countries. In the Common Market we have even come to the conclusion that a certain measure of understanding on wages and incomes policies is essential. In some countries excessive wage increases are the result of too high a level of total demand. This might be prevented in future by more vigorous fiscal and monetary policies. In other countries, however, excessive wage increases are mainly due to the aggressive behavior of trade unions or to wild-cat strikes. These problems can hardly be solved by fiscal and monetary measures alone. If wage explosions like those of the past should occur again in some Common Market countries, there is indeed not much hope for a monetary union.

All these difficulties confronting us in the Common Market would also confront a world central bank. In some respects the difficulties might be less because the integration process would not have to go so far as in the Common Market. In other respects they would be even greater because a world central bank would have to deal not only with a restricted number of highly industrialized countries but also with a great number of less developed countries.

Even the management of international liquidity involves great differences of opinion and wide areas where judgment is required, as we know from discussions of the past. The need for international liquidity depends very much upon the efficiency of the adjustment process. If exchange rates are realistic and the disequilibria in the balances of payments are modest, less international liquidity should be needed than in the reverse case. This is why those who advocate greater monetary discipline do not favor large increases in liquidity, while countries in chronic deficit generally take the opposite view. My personal view is that we did not have too little but rather too much global international liquidity in the past. Otherwise creeping inflation in the world would not have been as persistent as it in fact was. Others seem to regard the creation of Special Drawing Rights at the rate of 9½ billion dollars over the years 1970, 1971 and 1972 as insufficient. It has already been suggested that the amount of Special Drawing Rights to be created should be considerably increased for the years from 1973 onwards. In my opinion, international liquidity has been insufficient only for countries in chronic deficit, but by no means from a global point of view. In the future, it might be different. But for the time being we are suffering not from a shortage of international liquidity but from an inadequate adjustment process. Balance of payments deficits should be removed as soon as possible either by taking internal corrective measures or, if necessary, by altering the parity. They should not be facilitated and prolonged unduly by allowing the deficit countries to finance their deficits directly or indirectly for too long a period.

The concept of international liquidity has never been precise and is even less precise nowadays than it used to be. For instance, swap lines certainly represent potential international liquidity. The same is true of the credit lines in the Fund. And what about the Euro-dollar market? It would be wrong to relate international liquidity exclusively to official reserves. There is an interrelationship between commercial and central banks. Although the Euro-dollar market may not affect the total of international liquidity, it functions as a pool of international liquidity, whether private banks or central banks hold the dollar balances. What kind of liquidity, therefore, should the world central bank attempt to manage? It would certainly have to rationalize the whole reserve-

creating process and to exert an influence upon the behavior of reserve-creating countries. Here, I am in complete agreement with Mr. Martin. I also agree with him that the Euro-dollar market should somehow be supervised, although I do not know how this could be achieved in practice.

It has often been said that the creation of Special Drawing Rights was the most important step so far towards a world central bank. It is claimed that the Special Drawing Rights system provides the means for a collective control over the supply of international liquidity. This sounds very convincing in theory. I cannot as yet, however, see that it will fulfill this expectation as long as, in addition to special drawing rights, dollars and other forms of international liquidity are being created in an uncontrolled manner. For the time being IMF cannot be regarded as a real regulator of the total volume of reserves.

There are also those who say that the international monetary system has been transformed into a dollar system in recent years, meaning that the Federal Reserve Board in Washington is already functioning as a kind of world central bank. So long as deficits in the balance of payments of the United States provide the rest of the world with additional liquidity, this conclusion is not wrong. In fact, in this respect the Fed possesses all the attributes of a supranational bank. But we have to bear in mind that the Fed is managing the American money supply with an eye to the liquidity needs, not of the world as a whole, but only or mainly to the needs of the American economy. The changes in dollar holdings outside the United States are the result, not of a deliberate planning of international liquidity, but of whatever the outcome of the United States balance of payments happens to be.

I agree that an extreme shortage of international liquidity might provoke a demand for dollar reserves resulting in American balance of payments deficits. Such a situation does not however exist now. It seems to me that an improvement of the American balance of payments would be highly desirable, as the creation of Special Drawing Rights together with reserve creation out of the American deficits might increase total reserves too much, not to mention that the outside world might hesitate to accept dollars deriving from the United States deficits indefinitely. The dollar standard is not yet an accomplished fact accepted by everybody.

Let me sum up. Some of the functions of a world central bank are already being performed. In view of conflicting national interests and of the different aims countries still pursue it would, however, be difficult to reach international agreement on a bank operating as a top central bank of national central banks with full power to supervise the international monetary system, to be solely responsible for the systematic management of the international money supply, and to operate as a lender of last resort with the right to enforce monetary discipline on member countries. It would therefore be wise not to strive for utopian goals but to try to make less dramatic progress within the already existing machinery. The IMF as an already existing institution would be best qualified to streamline and improve the present system. Other international institutions like the BIS could render a useful service too.

I cannot help feeling that in the past we have laid too much emphasis on technicalities and too little on monetary discipline. Even the most perfect institutions are of little value if there is monetary disorder in leading countries. No monetary system, however intelligently designed, can replace sound policies. Discipline begins at home. Let us try to put our own houses in order, let us try to get rid of inflationary practices and let us try to improve the adjustment process and the balance of payments situation. For the time being this is more important than discussions about reserves and liquidity.

Perhaps we should alter parities more often than in the past in order to remove disequilibria before they do harm to the whole system. I am not a friend of floating rates, however, nor am I in sympathy with the idea of an automatic system of "crawling pegs," as it would weaken, rather than strengthen, monetary discipline. A slight widening of the band around parity might be useful, but is certainly not a remedy for our problems.

The dollar is still the leading currency of the world and the backbone of our monetary system, whether we like it or not. As things stand, a strong dollar means a strong system, and a weak dollar means a weak system, and a world central bank could hardly alter this state of affairs.

W. Randolph Burgess:

Dr. Blessing, we are very grateful to you for setting forth the prob-

lems so emphatically and vigorously, and I hope the discussion will center round these issues that are now so clearly drawn.

Now we turn to a different phase of the discussion, and we call on someone who will give us a picture from a Latin American point of view, a man who has been head of the Venezuelan Central Bank and now runs an important private bank, Dr. Alfredo Machado Gómez.

Alfredo Machado Gómez:

After the wide-ranging review provided by Mr. Martin's illuminating and comprehensive speech and the timely and penetrating comments by Mr. Blessing there is not much left to discuss in this short period of time. I will, therefore, limit myself to some brief comments on the subject of the world central bank as it appears from—I was going to say the vantage point, but it is probably the disadvantage point of a developing country. My emphasis will be on certain aspects of the topic which bear on the specialized institutional requirements of the developing areas of the world.

I will first comment quickly on what seems to be the requirement for the kind of world that is developing under our eyes. Then I will briefly refer to the technical problem of the mechanism of adjustment of balance of payments in all developing nations. Finally I will make some cursory remarks on some experience in monetary cooperation in Latin America.

As to the world situation, I feel that, as the decade of the 1970s begins, we face a time of momentous change. Continuities as well as discontinuities of trends, to use Drucker's scheme of analysis, are likely to mold and shape our tomorrow, the closing decades of the 20th Century. These changes are, in the author's words, our "recent future"—both already accomplished facts and challenges to come.

Major changes exist in four major areas. The explosion of the new technology; a new socio-political reality of pluralistic institutions; a new universe of knowledge; and, finally, and of utmost concern to us here today, the gradual change from an "international" economy to a "world" economy. It might be too fine a point to make this distinction, but it is one way of dramatizing the fact that different situations require different institutions.

What are the major changes in the international economy? Imperceptibly, there has emerged a world economy. The world has become, in other words, one market, or as Drucker says "One global shopping center." Yet this world economy lacks full-fledged world embracing economic organizations. Most of our present institutions were created in response to the needs of the system of national states, preserving to a great degree qualities of national sovereignty. Now institutions like the ones we are seeing coming to the fore, the Euro-dollar market and the multinational corporation, show general characteristics which correspond with a different stage of evolution, where nationality becomes secondary, and the institution operates to soften the concept of individual, political or geographical national sovereignty. The multinational corporation and the Euro-dollar market, which have come to the fore recently, are creating new tensions in various areas of the world.

The peripheral countries of the world have been overcome by the sudden awareness of being subject to the tensions and distortions generated by some of the activities of the multinational corporations and by the Euro-dollar market, while the main industrial countries in the world have been affected by the re-emergence of the United States as a capital importing country through the Euro-dollar market. These two phenomena of the new world economy pose problems which are new and which are providing both challenges for the incipient world economy and new tools and solutions for the monetary authorities. There are thus both promising developments and threatening connotations in the advent of these two phenomena.

Today's world economy owes not too much to political imagination or decisions. It is coming into being despite political fragmentations. The demands, the appetites, the values are preceding even the creation of trading units. To a certain extent the European Common Market was a belated institutional acknowledgment of what had become the reality of economic perception and of consumer behavior a good many years earlier. The interaction between different nations' economies is growing closer and stronger. Mr. Martin and Mr. Blessing have emphasized this fact. Every country has always had to adjust its internal money and credit policies to the realities of its international economic position.

The cues we seem to get from this new world economy are that some international monetary institutions, some sort of central bank, if it is necessary, or expansion of the existing institutions, seems to be very welcome and desirable at the world level. As Mr. Blessing has observed, a purely technical decision-making process, which would be ideally suited for this kind of organization, would be politically very difficult to accept. Nevertheless, it still looms in the future as something desirable for the world as a whole.

In one important respect the world economy and the management of the international monetary system is much better off now than it was during the interwar period. It is not yet fully satisfactory, as Mr. Blessing has emphasized and Mr. Martin indicated, but important strides have been made as a result of the institutional streamlining of the IMF, the BIS and the European Economic Community.

I would like now to move from the world approach and discuss very briefly the significance of a world central bank in the context of developing countries. The mutual benefits derived in the past from the coexistence of the IMF, the OECD, the EEC, the BIS, and Benelux, to mention only a few, amply demonstrate the complementarity, rather than incompatibility, of concentric or parallel regional or interzonal approaches to world-wide economic cooperation. This is likely to prove true in Latin America as well as in Europe and other parts of the world.

However, among the many technical differences between the monetary and exchange problems in developing areas as compared to industrialized regions, a most critical and probably the most typical is the lack of interconnection or interdependence amongst countries which importantly affects the balance of payments adjustment mechanism. This problem reflects some shortcomings amongst the developing economies. But even from the viewpoint of monetary coordination, there are some important handicaps resulting from the typical situation of contrast in most of the developing economies where a developed side exists side by side with backward segments of the economy. The developed area is always the export sector: that sector has been developed under the impact of external forces which molded its shape according to the perspective and requirements of the international market. Its rate of development is determined by the importance of the external sector, and this rate of development is not usually consistent with the needs of the internal economy of the country.

Suffice to say that these peculiar characteristics complicate the adjustment process in developing countries.

Monetary authorities within the Third World have followed with great interest, attention and hopes, the deliberations and conclusions reached by OECD's Working Group No. 3. It is difficult not to agree with most of the conclusions reached in their report. Nevertheless, in my opinion quite a number of those recommendations could not, for several reasons, be applied successfully to the great majority of the developing nations.

From a structural viewpoint, there are flaws and weaknesses which affect adversely the conditions of monetary stability and convertibility, international capital inflows, effectiveness in the application of fiscal and monetary policies, labor force mobility and capital market organization.

The adjustment and coordinating mechanism, so much influenced by the level of international reserves and its resilience, functions poorly, if at all, in most developing countries. This is due to the limited composition of export items, mainly primary products, which results in a narrow exposure or contact with the rest of the world and affects downward the level of reserves as a result of a deterioration of the terms of trade. So far, this is all very much commonplace, but I want to get to a point which we consider is slightly new, namely, that due to that reserve situation, the developing countries lack the shock-absorbing device to reconcile internal monetary stability with external development.

The difference between external and internal pressures often exceeds the cushioning capacity of the reserves, and there are then only two alternatives: either to stop convertibility and stability of exchange rates; or to apply deflationary policies which are socially undesirable and politically dangerous in areas where already standards of living are very low.

The argument that developing countries do not exercise monetary restraint is, in my view, an oversimplification to explain such results. Lack of discipline at the monetary, and sometimes at the fiscal, level is undeniable. But it is also true that the impossibility of satisfying the requirements of the system has been a cause of such monetary disorder. The strict application of the rules of external stability produces internal fluctuations and pressures which result in serious maladjustments. Out of frustration, in the face of this situation, a tentative conclusion reached

by many authorities in the developing world is that the backward economies are strongly handicapped in trying to play the game under the present exacting rules. Many adopt the quip made recently by a French paper: "Is it reasonable to be reasonable in an unreasonable world?"

Under these conditions, the solutions to the problems of an adequate adjustment process depends not only on the monetary mechanism but also on a number of extra-monetary devices. It is, therefore, clear that there is an institutional vacuum and an important role to play in the coordination of all these financial and monetary tools for a world or regional central bank or international monetary authority.

I will comment now on some steps that have been taken in Latin America in an attempt to increase monetary cooperation and therefore to improve the general situation of the adjustment mechanism. New world financial developments offer all developing countries and their central banks new challenges and opportunities which can briefly be summarized under the following headings: 1) foreign investment of central banks' reserves, if any; 2) Latin American securities flotations in foreign markets; 3) central bank arrangements in support of mutual trade; and 4) central bank arrangements in support of currency convertibility and stability.

In the last ten years Latin America has taken some important strides in arranging for institutional cooperation among central banks to provide, first, a center for interchange of ideas; this takes place two or three times a year. Then, arrangements for clearing-house functions have been rather effective: within the Central American Common Market about 80 per cent of transactions are cleared through the settlement mechanism. In South America only about 50 per cent of transactions are cleared, but this is the beginning of a cooperation onto which more significant arrangements can be grafted later on.

To conclude, the main theme that I have tried to outline in these comments is that institutions, both national or international, are born out of surging needs, new developments and a world that changes at an ever faster pace.

It seems quite clear that the global money and credit requirements that go with these changes need an adequate monetary world institution to prevent economic fluctuations from turning into severe crises.

As a second corollary derived from these cursory comments on the mechanism of adjustment of the balance of payments in developing countries, I hope I have emphasized that some of the pitfalls in that process are partly due to inadequate centralization of reserves and their management, as well as of monetary administration, like that which is beginning to be achieved by the IMF or even the BIS. A world economy with a world monetary system based on the recent creation of SDRs seems, in the medium term and long run, to need a coordinating and centralizing monetary authority with more powers.

The small and medium countries of the world feel that more thought needs to be given to the way in which a mechanism can be put into practice to preserve monetary stability better, not only among the Group of Ten, but also amongst the weaker but more numerous smaller nations. Only the industrialized and the powerful nations can bring about the necessary institutional devices to cope with some of the problems that we have enumerated here today.

May I recall a meaningful statement made some years ago by Governor Coombs of the Bank of Australia: "We think that the medium and smaller countries which lie outside the Group of Ten, who enjoy sometimes needling and criticizing the mighty, should also recognize that this privilege carries with it some responsibilities." In particular, we in the developing countries must demonstrate that we are willing, and indeed able, to manage our own currencies, our own balance of payments, and our own economies with reasonable efficiency, and therefore able to make our contribution to the world's stable development, provided that a satisfactory world climate and institutional framework is maintained for us.

There is in New Zealand a mythical story of a Maori warrior, who put out to sea in a canoe and was overtaken by a storm. Like many mortals when they are in peril, he prayed. However, the terms of his prayer, the New Zealanders say, were not that the storm would subside, or that he should be rescued, but that God should move away the clouds so that he could see the stars and thus be able to navigate. I feel that when we appeal to the mighty—since only they can provide an institutional framework and a propitious climate—what we are asking them to do is to move away the clouds. We should at the same time, be able to assure them that when the clouds are removed away, we will be able to steer our own canoe.

W. Randolph Burgess:

I thank you, Dr. Machado. You have added a very important element to the equation that we will have to weigh in the balance as we think about these things.

We now have, as the final speaker, Professor Harry Johnson. He is basically a Canadian, but he commutes between London where he is a professor, Chicago where he is a professor, and other places in the world where he professes one thing or another very importantly. We are delighted to have him in this important position as the final discussor.

Harry G. Johnson:

At this stage of the proceedings, we have come a long way from the paper presented to us, and there is a temptation for a speaker to give his own views without too much reference to the views of the official speaker. I would like to go back on that temptation and return to the presentation that William McChesney Martin has made to us this afternoon.

I think that the paper he prepared for us, and still more the presentation he gave, is a very fine tribute both to the vision of Per Jacobsson, in whose honor these lectures have been established, and to the intention of the series, which is "to encourage the thoughtful and informed consideration of international monetary and financial questions." I think that the paper conforms exactly with that specification, but it gave us, at least the presentation of it gave us, much more. It gave us a sense of passion and concern about the issues which I was very glad to hear.

People like Per Jacobsson, whose portrait is in front of us, and William McChesney Martin, who has presented his paper to us, have carried great responsibilities in the international monetary system, and in my view one can only do that successfully if one does have some concern about where the system is going and what direction progress lies in, and what should be done about it. Unfortunately, the requirements of civilized existence require that people with this kind of passion have to hide it as long as they are in office, and can show it only after they have left. Again, I am very grateful to Mr. Martin for showing us something of the concern about the world system which obviously has motivated him.

His paper is concerned with the basic issue facing the international monetary system—which is the question of where we stand now, and where we are going. Mr. Martin answers that question positively and resolutely: we have been moving towards a world central bank, at least functionally, if not in institutional form, and that is the direction in which we should continue to move. I am very pleased that he should make that message so clear and so forthright and I hope that the audience who heard it, and those who will read his words, will take it to heart.

I think it is particularly important, this message, coming as it does from a former Chairman of the Board of Governors of the Federal Reserve System, since the United States dollar has dominated the international monetary system in recent years, and this has produced a certain conflict of interests in the American Administration and in American views and pronouncements on the system—conflict between the narrowly national self-interest in promoting the use of the dollar for a variety of reasons, and on the other hand, a genuine and generous interest in the system as a system and in the improvement of the monetary framework within which we have to live.

Mr. Martin's paper divides itself into two parts, a backward-looking part and a forward-looking part. I refer to this as a Janus-like performance. Some people, I think, after this afternoon may regard it as more Cerberus-like, with Mr. Martin guarding the gates of hell rather than guarding legitimate business. He looks backward to the disasters of the 1930s, to the lessons drawn therefrom, and to the fact that we have avoided those disasters in the postwar period through the development of international monetary cooperation. I found this part of his paper encouraging in some ways and discouraging in others. It is encouraging because it appeals to the sense of interdependence, to the sense of human responsibility to one another, the need to cooperate. And that I think is important, because too often, in this area in particular, people get blinded by narrow concerns of self-interest.

I found it discouraging from another point of view, in that it plays down the most important factor which has underlain the growth of international monetary cooperation in the postwar period, and that is the growth of understanding of what the system is and what its requirements are. Recognition of interdependence, a sense of responsibility to one another, is of no use unless you know why you are interdependent

and what your responsibilities are. It seems to me that the great difference in the postwar as compared with the interwar period is that central bankers and related experts have come to understand what the system is and what its problems are. I do not think the difference between the interwar period and the postwar period can be found in the fact that all of a sudden central bankers have become humane, generous, cosmopolitan, public-spirited, and not bound by national self-interests. I think that the people of the 1920's and 1930's, judging by the history of that period, were just as public-spirited, just as anxious to do good for the world as any central banker I have met, including during the present sessions. The trouble was that they did not understand what the system was and what its problems were. What has happened is not that people have suddenly changed their human nature but that they have learned as a result of crisis, consultation and so forth, what the nature of the problem is and what has to be done about it. I think we academics can claim some credit in the educational process, though I am not prepared to assert that we were always ahead, since I think sometimes we have been behind, particularly with the invention of SDRs.

Still, what has been learned is that we have to have in the international system what central bankers provide in the national system, and this is essentially two functions: the first is the lender of last resort function; and the second is the provision for a steady growth of ultimate reserves for the system as a whole. These lessons have been learned as a result of a succession of crises, and, I think one can fairly say, the central bankers have responded fairly imaginatively to these crises.

There are two traps, as I see it as an academic scholar, in the central banking business. The first is the belief that every national aspiration can be achieved simultaneously; and I am afraid that some of the remarks by my two predecessors in commenting this afternoon retained traces of that fallacious opinion. The second is the temptation to believe that if you make a small action and a big statement, people will believe the statement and not notice the action. We have had some of that in the postwar period also, notably on the occasion of the gold rush of 1968, but, by and large, I think the central bankers of our generation have learned that big words are no good unless they are accompanied by big actions, and they have learned to take big actions.

That, I think, is the imaginative and courageous part of the development that has occurred so far. As a result of that, I think that some of us academics who have been theorizing about a collapse of the system prompted by a liquidity crisis will be proved wrong on every occasion on which possibility of proof arises. I think central bankers have learned that you need to do internationally what you do domestically in times of crisis: you have to lend without stint, and you have not only to lend without stint but to make sure that everybody knows you are prepared to lend still more if you have to. So I don't think we need fear a liquidity crisis any more, and in fact we have developed the lender of last resort function which the system needs.

There has, however, been a cost to that, and that is, because it has been a matter of crises, the development has been dominated, to some extent, by blackmail on the part of the less responsible countries. In particular, the system has operated to impart an inflationary bias to the world monetary system as a result of subservience to the needs, on the one hand, of the United Kingdom, which is both big enough and weak enough to be able to extract more money from the others than it really deserves, and the United States which is big enough and strong enough to be able to extract the same sort of help. So, in spite of Mr. Martin's glowing words about the net beneficial pressures of cooperation and consultation in inducing countries to behave properly, I think Dr. Blessing perhaps has more nearly the right end of the stick when he points out that the system has not worked quite that well and that there is an inflationary bias in it.

Recognition of the need for the lender of last resort function is really not that difficult a problem. In the history of domestic monetary systems before central banking we had many cases in which the big commercial banks realized, in times of crisis, that they had to get together, lend to each other and to be willing to lend without stint, and one would expect therefore that this particular function is one that central banks in a world system could learn fairly easily that they had to perform, even though it may be painful at the particular times it is necessary.

The much more difficult problem has been to arrive at recognition of the need for a managed deliberate expansion of the ultimate reserves of the system. Here the temptation of central bankers is to believe that you can solve this problem by the same means as you solve the other

one, namely, by temporary short-term credit, swaps, and so forth and so on, and that is a temptation which could be disastrous. But, fortunately for us, the central banks have learned, though somewhat later than they solved the other problem, that the system does require a deliberate and managed expansion of the basic reserves—and that is a truly revolutionary idea.

In fact, I think Mr. Martin has been rather—well, I don't know; his judgment and mine are things for you to weigh up, not for me to pass judgment on—I think he may have been too blandly reasonable in emphasizing the continuity of development through the postwar period to the idea of the SDRs. He may, while reassuring some people who like to believe that if you look backwards you can always predict the future, conceal the truly revolutionary nature of the idea of deliberate creation of international reserves needs. It is a bold adventure that the system is undertaking, and it requires a lot of adjustments; and those adjustments won't be made properly unless people understand where we are going. We are not just repeating the past with small changes. We are really moving forward to the creation of a new, genuinely cosmopolitan type of international system.

Special Drawing Rights, as Mr. Martin said in his paper, are the first step towards this. There are many other steps which he outlines and which have taken place through different international institutions, but this is the first real step towards a world central bank. It is the first step towards deliberate creation and management of international reserves and, as I see it, there are six problems that lie ahead of us in this field and which will have to be tackled. Mr. Martin deals with these in his own way, and he dealt with some others. I deal with them in a different way, and the reason for that is that he is a highly successful practitioner and I am a practically unqualified academic economist.

The first problem is that the new reserves are marginal to the total of existing reserves. That means the management of them will have to be very carefully done if, in fact, the result of their creation is to give us more stability and not less. It will take a great deal of work on the part of the International Monetary Fund staff and on the part of the central bankers, to make sure that the creation of these new reserves really contributes to world stability and doesn't just throw another element of instability into the system.

The second point which Mr. Martin deals with and Dr. Blessing mentioned also, is that what happens is going to depend very much on the nature of United States policy. And this, unfortunately, is not a simple matter of U. S. policy by itself, because U. S. policy is going to be interdependent with the policies of other countries and with the management of SDRs themselves. Ideally what we would like to see would be that SDRs provide the increment of world reserves so that the United States can have a balanced balance of payments, which in turn implies that other countries don't get too greedy and try to get more reserves than collectively has been decided should be provided.

The third point, which Mr. Martin also mentioned, is that it would be highly desirable in the longer run if all of the existing reserve assets could be consolidated and become one asset, managed by the equivalent of a world central bank. In order for that to happen we will have to reach a position in which the other assets are more-or-less stable in quantity from year to year so that consolidation of them doesn't offer the prospect of any substantial gain to one country and substantial loss to another. And that in turn ties in with the consideration I just mentioned as to the interdependence of all these different policies.

The fourth question which Mr. Martin raised is the question of moving onwards from providing for stable growth of world reserves to providing contra-cyclical management of those reserves. That is an idea which is highly tempting to any central banker: that you don't just sit there, you do something, and what you do is that you try to make the reserves move contra-cyclicly so that you achieve greater stability. Well, that naturally appeals to Mr. Martin, and I am sure it appeals to many other people in the room, but it definitely doesn't appeal to me and the reason is that I have studied the evidence as to how skilful central banks are in managing basic reserves so as to perform a contra-cyclical function and make the economy better than it otherwise would be. That evidence shows that they are very poor indeed at the job, and, considering what sort of organization a world central bank would have, I have even less confidence that a world central bank could sit there skilfully "fine tuning" the world economy by deft adjustments of SDR increments or, going further, by astute open market operations, in particular money markets. So my view on that subject is that we should try first to get a stable growth of the ultimate reserves of the system, provide stability which we haven't had before,

and only after that should we consider whether in fact it is possible to improve on stable growth by deliberate destabilizing policy aimed at contra-cyclical management.

The fifth question is the point of surveillance of the Euro-dollar and Euro-bond markets. Here I feel that the old central bank devil is creeping out in Mr. Martin in spite of his generally generous-minded attitude towards the world. It is one of the temptations of central bankers to believe that they know better than the market does what sorts of credit instruments are creditworthy and what are not, and to believe that without their help private competition must inevitably result in financial disaster. I don't believe that. I believe that the Euro-dollar market and the Euro-bond market instead are developments which reflect the weaknesses of central banking, particularly in Europe, and I do not really see that anybody has the intelligence or the ability to do better than that market does. And I see no real reason to worry about the problem.

Well, the final point concerns the question of regional imbalances. It is on this subject that I think Mr. Martin's paper is at its most perceptive, and that is a prize that it is difficult to award, given the range of subjects he covers and the wisdom he brings to bear on them. Regional imbalances, as he points out, are not a problem within a nation but are a problem in the world economy; and the reason is precisely that the regions of a country do not have autonomous policy devices at their command, whereas nations do. Once you have a lever to pull it is by no means guaranteed that you pull it in the right direction at the right time, especially if somebody is telling you that you should pull it the other way. This means that there will be in the world economy problems of adjustment between regions which there will not be, or are not, within a national economy, and Mr. Martin, along with many of the rest of us, believes that one step towards solving that problem would be more flexibility of exchange rates. I found myself torn on this issue. I have always been an advocate of rate flexibility, and I certainly believe that in the present state of defective development of international cooperation, which Dr. Blessing laid out for us at great length, some flexibility of exchange rates is absolutely necessary if the system is to function on the whole in a liberal way. But from the longer run point of view, the question does arise whether we might not be better off in our world economy, which we are trying to build with

this system, with complete rigidity of exchange rates as we have within a nation, but allied with the development of the kinds of mechanism we have within a nation to soften the blow of commitment to a single currency—that is, arrangements for deliberate transfers of income from rich regions to poor regions, and arrangements for encouraging the mobility of labor, of capital, and of technology between regions. In other words, should we not look instead to deliberate efforts to make the maintenance of a fixed exchange rate between the regions tolerable to the people who live with it rather than providing for more flexibility? The argument for a fixed rate system is essentially the argument for a common currency. Rate flexibility is an attempt to get the advantages without too many of the disadvantages. And while, in the present state of affairs, there is a very strong case indeed for more rate flexibility, in the longer run it seems to me we ought to be aiming for one world currency managed by one world bank.

There is one final point there, which is that, if we do provide for more flexibility of rates, the result may not be the establishment of a world currency and a world central bank, but instead the gradual rise to dominance of that national currency which has the most advantages and attractions, and that would mean that establishment *de facto* of a world dollar standard—which I do not think would be in the world's interest as we understand at present.

W. Randolph Burgess:

Professor Johnson, that was a magnificent summing-up. We are very grateful to you. Now, there have been some questions turned in, and Mr. Martin may want to comment on some of the things the other speakers have said.

CLOSING STATEMENTS

Mr. Martin:

I think that Professor Johnson put his fingers on all the weak points in my paper and I think, as a free market man, that he has a valid point when he comments on my talk about supervision of the Euro-currency/Euro-bond market. But I think he probably noticed that I didn't say anything about open market operations. This would have been the central bank approach, buying and selling these currencies, and I realize the difficulties that are inherent in this. As I tried to indicate in my comments, I realize all these hazards. I think that we have to overcome them one by one. I think some of them have to be adjusted. But basically I think that we are on the right trend and I think we can make progress along that line. That is all I want to say on that.

I sympathize with Karl Blessing on the self-discipline aspect, and I think he pointed that out beautifully, as he always does. I do concede that we have to recognize that each country has to have self-discipline and that, if they don't, we are in trouble. That is the basic reason we were in trouble in the sixties.

The problem of reserves and of liquidity which goes along with that is, in my judgment, a minor problem. For a long time I had quite a problem in my own mind as to whether we really had a shortage of liquidity or a shortage of reserves, and I tried to give you a little statistical approach to this. It seems to me that in the five years of 1964-1969 it was clear that, other than through an increase in the price of gold, on the most optimistic basis, there was not foreseeable any increase in reserves in the magnitude that might be needed for the colossally developing world trade. We all want to see world trade

develop, and it was on that basis I think that the SDR operation was started, and I think many of you in this room know that this was debated over a two-year period in every possible way. I remember very vividly the two meetings in London where Secretary Fowler was dealing at considerable length with the question of how many SDRs we should have. There were some people who thought it wasn't any good at all to have SDRs at all unless we had 15 or 20 billion, and a lot of people who thought that 1 billion was going to be too many. It was out of this debate and out of that sort of give-and-take that we finally arrived at the current set-up.

Now there is this point, and I emphasized this in my paper and I sincerely mean it, that the United States, by coming forward with this idea, has put itself on the line. I think that they are going to recognize their balance of payments problem and that they are going to try to move towards zero or nearly zero at least on the official settlements basis.

Now, I have a question here with respect to regional grouping and I can't give a very satisfactory answer to that: *whether regional grouping is desirable or undesirable*. I think it depends on how it is done and how it is worked out. The thing that I pointed out in my paper was that we have been fortunate, by and large, in not having had a dispersal of this monetary operation among too many different organizations.

Another question here asks "*What is the balance of payments policy, apart from just full employment and stable prices?*" I can say, as a former Chairman of the Open Market Committee, that in the last three years there has never been a meeting of that Committee where there hasn't been a real discussion of the balance of payments impact of monetary policy and of fiscal policy on our balance of payments. In fact, I used to call it up regularly on the agenda. We would go through a review of the domestic situation and then I would call for a review of the balance of payments situation, and out of that the U. S. has tried to forge a policy. At one time, of course, it went pretty far in the direction of controls, trying to solve the balance of payments that way. When the new Administration came in, they thought, "We are for free enterprise, you know, we will just throw them all off over night." But it wasn't quite that simple. There has been quite a difficult problem of adjustment, because all these things have to have a certain give-and-take in them.

There is one question addressed to Karl Blessing: "*How do you assess the likelihood that the Common Market countries achieve a monetary union?*" Do you want to say anything on that, Karl. No? Well, I don't think there is really much to add to that. The other part of the question: "*What would be the effects on the dollar?*" I think the basic question here is whether the dollar is structurally overvalued. My answer is no, it isn't yet. It may become that way, but I think a straightforward answer, in my judgment, is that it is not overvalued at the moment. We are wrestling with a very serious balance of payments problem and a very serious inflation problem. The thing that probably is causing us the most long-range concern is the fact that it is only because Europe is inflating faster than the United States that we are not in more trouble than we are. Yet people say, "You are exporting your inflation to us." Well, to some extent that may be true, but by and large it is a ring-around-the-rosy. I think we just have to wake up to the fact that this inflation problem is going to require that everybody put his shoulder to the wheel and tackle it.

The next question here I have already commented on: *whether the SDRs don't inject a new inflationary element into the world picture.* My answer to that is yes, they may if they are improperly handled. This is one of the serious problems that we have to wrestle with. If the U. S. balance of payments falls apart, and we don't have a proper balance, why I think we are going to head into a very serious period of trouble again.

I don't know that I can add anything to that, Mr. Chairman. That covers most of the questions I have got here.

* * * * *

Mr. Burgess:

Well I think that completes the discussion. You have the subject laid out before you and I know that this document, as it is published, will have careful study and will undoubtedly affect the monetary policies of the countries of the world.

Now, what remains for me to do is first to thank all those who have taken part, particularly Mr. Martin, who prepared this careful paper for us, the three speakers who followed and who gave us three different

approaches to the same question that fit together, nevertheless, into a pattern. We are greatly in their debt. Again, we are very grateful to the University for making this hall available and for cooperating with us; to the City of Basle and its officials; to the BIS; and to all of you who supported The Per Jacobsson Foundation. Let us adjourn the meeting.

Appendix 1

BIOGRAPHIES

William McChesney Martin, Jr. has most recently been Chairman of the Board of Governors of the Federal Reserve System, a post from which he retired early this year after serving since April 1951. He has served the U.S. Government as Assistant Secretary of the Treasury, as Chairman of the Export-Import Bank, and in a great variety of other posts. From 1931 to 1941 he was a member of the New York Stock Exchange, becoming its President in 1938. Mr. Martin was graduated from Yale University and has honorary degrees from over 20 universities. Entering the U.S. Army as a private in 1941, he attained the rank of colonel before leaving the service in 1945. Mr. Martin was born in St. Louis, Missouri; he now lives in Washington, D.C.

Karl Blessing was President of the Deutsche Bundesbank from 1958 until his retirement at the end of last year. He has been active in international central banking matters during his entire career, as a participant in the conferences for the establishment of the Bank for International Settlements, in which he later became a department head; as a member of the Reichsbank Directorate; and as Governor for Germany of the Fund. He has also been actively associated with a number of international commercial and industrial organizations. He now lives in Frankfurt am Main.

Harry G. Johnson is Professor of Economics at both the London School of Economics and Political Science and the University of Chicago. He was born in Canada in 1923 and studied at the Universities of Toronto, Cambridge, and Harvard. He is a specialist on international trade and monetary organization, and has lectured widely in Asia, North America, and Europe on the problems of the international monetary system.

Alfredo Machado Gómez, President of the Banco Central de Venezuela from 1960-1968 and member of its Board from 1948 to 1952, is now President of the Banco Mercantil y Agrícola of Caracas. During his term of office in the Central Bank he organized the Assembly of the Governors of Central Banks of Latin America and served as both the first and fourth President of this Assembly. Mr. Machado Gómez obtained degrees in political science from the Central University of Venezuela and in economic science from Columbia University in New York; he also studied at Stanford University in California. He has written widely on economic topics and has been active in transportation and related industrial and commercial enterprises.

Appendix 2

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Appendix 3

Publications

Proceedings

- 1964 *Economic Growth and Monetary Stability*
Lectures by Maurice Frère and Rodrigo Gómez (Available only in Spanish; English and French stocks exhausted)
- 1965 *The Balance Between Monetary Policy and Other Instruments of Economic Policy in a Modern Society*
Lectures by C. D. Deshmukh and Robert V. Roosa (Available only in French and Spanish; English stocks exhausted)
- 1966 *The Role of the Central Banker Today*
Lecture by Louis Rasminsky
Commentaries by Donato Menichella, Stefano Siglienti, Marcus Wallenberg and Franz Aschinger
(Available only in English and Spanish; French stocks exhausted)
- 1967 *Economic Development—The Banking Aspects*
Lecture by David Rockefeller
Commentaries by Felipe Herrera and Shigeo Horie
(Available in English, French and Spanish)
- 1968 *Central Banking and Economic Integration*
Lecture by M. W. Holtrop
Commentary by Lord Cromer
(Available only in English and Spanish; French stocks exhausted)
- 1969 *The Role of Monetary Gold Over the Next Ten Years*
Study by Alexandre Lamfalussy
Commentaries by Wilfrid Baumgartner, Guido Carli and L. K. Jha (Available in English, French, and Spanish)

Other Publications

- The Per Jacobsson Literary Inheritance*
reprint of article by Erin E. Jucker-Fleetwood which appeared in Vol. XIX—1966—Fasc. 4 KYKLOS—The International Review for Social Sciences—Basle
(Available from the Foundation in English only and in limited quantities)