

policies, the 1955 European Monetary Agreement would hardly have been put into operation in December 1958 without substantial revisions, except for a series of unforeseen events which left little time or hope for a successful renegotiation. A fundamental, and long overdue, revision of the EPU Agreement had been repeatedly postponed pending the results of the Free Trade Area discussions. When the latter finally collapsed in December, the maintenance of EPU in its then existing form became more anachronistic than ever, but the liquidation of EPU automatically entailed, under the 1955 Agreement, the simultaneous entry into force of the European Monetary Agreement. Final action was precipitated by the French decision to readjust and stabilize their own monetary and exchange system, preparatory to the first round of tariff and trade liberalization of the European Economic Community on January 1, 1959.

This hurried time table and the bitter atmosphere resulting from the breakdown of the Free Trade Area talks precluded any further negotiation of an EPU or EMA revision at that time. Yet, the need for such a revision had been clearly affirmed in all the Maudling Committee discussions. The EPU Managing Board had been instructed to explore the problem, and had already presented preliminary reports to the full committee. There is little or no doubt that the present EMA system will require substantial modifications if and when the European Economic Community and the other OEEC members succeed in patching up their differences, and agree on some new form of economic association among the seventeen OEEC countries. The mutual commitments to be undertaken by members in the trade field would be more ambitious than those of the OEEC Code of Liberalization, and would have to be supported by correspondingly strong commitments in the money and payments field.

The keystone of such a reform of the present EMA would bear a close similarity to the proposals advanced above for the reform of the IMF. The project would be regional, rather than world-wide in scope, however, and could probably be negotiated and implemented more easily, more rapidly and more fully within such a framework.

The participating countries would establish jointly a Clearing House centralizing all payments among their separate central banks. These payments would be effected through corresponding debits and credits to the account maintained by each central bank with the Clearing House.

These clearing accounts would be fed, first of all, by the compulsory transfer to each country's account of any and all balances in another member's currency purchased from the market by its central bank or credited to it by another central bank. They could be fed, in addition, by transfers of gold, or convertible currencies of third countries, or even of other currencies specified by the Clearing in the light of its members' current demand for such currencies. The first of these two provisions would be designed both to simplify payments among members and to prevent any relapse into open or concealed bilateralism among them.

The clearing accounts would, of course, be fully convertible and could be freely drawn upon by their holders to make payments to third countries as well as to member countries. They would, moreover, carry an exchange guarantee in terms of a jointly agreed unit of account. This unit might, as in the case of the IMF, be defined merely and simply in terms of gold. A less rigid, and on the whole preferable, procedure might be to revive a unit similar to the former EPU unit of account, *i.e.* tantamount in effect to an exchange guarantee in terms of whichever European currency will in fact remain stablest in the future with respect to gold itself.<sup>3</sup>

The participating countries might be required, at least initially, to maintain in their clearing account a minimum balance equivalent to, let us say, 10 or 20 per cent of their total gold and foreign exchange reserves. Based on current reserve levels, these required balances would total today as much as \$2 billion if a 10 per cent "reserve requirement" were adopted. The resources thus placed at the disposal of the Clearing would be totally unaffected by intra-European disequilibria, since any decrease in some countries' global

3. Such a clause would have the same effect as a gold guarantee unless all member currencies modified in the same direction—upward or downward—their present parity with respect to gold. The application of a straight gold clause in such an event would probably result in unjustified windfall losses or gains for the debtors and creditors in the Clearing. It might be noted that the elimination of the EPU unit of account by EMA and its substitution by a gold clause for some transactions and a dollar clause for others would open a serious and unsolved question in the improbable event of a change in the United States gold price or gold policy. A whole article (Article 14), entitled "Modification in the United States Price or Policy for Gold," is devoted to this very problem, but its call for an urgent and comprehensive review of the Agreement in such a case is only a thin disguise for a total lack of agreement at this stage as to the way in which the situation should be handled. The needless introduction of such complications and uncertainties in the Agreement is difficult to explain except on the basis of British fears that the EPU unit of account might enjoy greater prestige than the pound sterling, displacing it gradually as a key currency in world trade and pay-

reserves and minimum deposits would then be exactly offset by corresponding increases in other members' reserves and required deposits. The resources of the Clearing would fall only as a consequence of global deficits of the OEEC area as a whole toward the rest of the world, and even then by only 10 per cent of the amount of such deficits. A cumulative deficit of \$10 billion would be necessary, for instance, to reduce by one half the funds initially placed at the disposal of the Clearing. Such an evolution would be highly improbable, and would in any case call for joint readjustment policies in order to harmonize the European pace of monetary and credit expansion with that of other areas, or for preserving a desirable pace of expansion against the impact of outside deflation through the negotiation of foreign credits or through an increase of restrictions on trade and payments with non-member countries.

The resources of the Clearing would be held primarily in gold and convertible foreign currencies, so as to enable it to maintain the world-wide convertibility of its members' accounts. The factors of stability outlined above, however, would make it possible for the Clearing—just as for any bank—to reinvest at short or medium term, within or outside the OEEC area, a reasonable portion of its assets without endangering thereby the effective liquidity of its deposits for their individual holders.

The lending procedures of the Clearing would follow the same general pattern outlined above with respect to the IMF. The criteria determining the overall amount of such lending, however, would be different, and far less automatic in character. The total amount of assistance provided to members would have to be adjusted in the light of the current inflationary or deflationary pressures within the area and of the evolution of the balance of payments and monetary reserves of the group as a whole toward the outside world. This would not, of course, ensure that the policies of the group as a whole would be wiser than those of other countries or than those which would have been independently followed otherwise by its national member states. The group's policies might be more inflationary or more deflationary, as well as less inflationary or less deflationary, more foolish as well as wiser, than those pursued in the rest of the world. The choice of policies open to it would merely be wider and freer than that otherwise available to its individual

members. It should certainly be exercised in such a way as to preserve freedom of trade within the area, and strengthen its ability to follow liberal policies toward the rest of the world as well. The latter result could not be guaranteed, however, in the absence of a sufficient coordination of policies and mutual financial assistance between the group and other major trading countries. Important tasks would thus continue to devolve on world-wide organizations such as GATT and the IMF, even though effective performance at that level is likely to develop more slowly and gradually than will prove feasible at the regional level.

As in the case of the IMF, the influence and means of action of the Clearing would be likely to grow at a rapid pace, as experience overcomes initial diffidence toward the system and the inertia of old habits and traditions. Its deposit accounts, particularly, might be expected to exceed largely, after a time, the minimum requirements initially adopted and even, possibly, to make these unnecessary. Those accounts should indeed prove highly attractive to member banks in view of the unique guarantees attached to them. The convertibility and exchange rate guarantees provided would eliminate the risks of unilateral inconvertibility or exchange rate devaluation inseparable from the current investment of monetary reserves in national, so-called "key" currencies. Default risks, moreover, would be practically eliminated by the obligation accepted by all members to channel through the Clearing all payments due by anyone of them to another. The overdrafts of a defaulting borrower would thus be automatically amortized by the transfers made to its account by any other member, and this procedure would not be dependent on the good faith of the borrowing country itself, but on the commitments subscribed to by all other members of the Clearing.

Finally—but only as long as the IMF reforms proposed above are not adopted—the Clearing might attract similar accounts even from central banks of non-member countries whose payments relations are largely with the EPU area. Indeed, nearly 40 per cent of non-EPU countries' merchandise imports originate in the EPU area, and this proportion exceeds 50 per cent for the countries outside the dollar-area. The European Clearing, based on a close alliance between sterling and other European currencies would tend to develop gradually into a powerful monetary center, susceptible to assume an international role comparable to that of London before 1914,

but which London alone has become too weak to perform today. Non-member countries could be expected to transfer gradually into clearing accounts some portion of the national currency balances now held by them as monetary reserves. Insofar as these balances are now held in non-member currencies—*i.e.* practically in U.S. dollars—this would strengthen the gross reserve position of the Clearing and result in some further expansion of its lending capacity. Insofar as they are now held in member currencies—practically pounds sterling—it might help smooth out the impact now exercised upon the debtor of such balances—practically the United Kingdom—by fluctuations in their overall amount. The largest portion of these fluctuations would indeed be associated with the settlement of imbalance between the owners of the balances and the European area itself, and would not cause any drain on the Clearing's gold and dollar reserves, nor any change in its other assets, but merely a reshuffling of its net claims or debts *vis à vis* the United Kingdom on the one hand, and its other members on the other. While persistent movements of this sort in the same direction would obviously require in the end cash settlements among the member countries concerned, a great many of them could properly be cushioned by the Clearing and help avoid or smooth out the undesirable pressures which they would otherwise exercise upon these countries' policies.

A European Clearing House would therefore be able to offer a substantial contribution to the preservation of international liquidity and to the reduction of the dangers attendant to the use of national currencies as international monetary reserves. It could not, however, solve such world-wide problems as fully and effectively as a revised IMF might do. The proposals advanced in this chapter, therefore, should not be regarded as a lasting substitute for the IMF reforms discussed in the preceding chapter. On the other hand, neither should a global IMF approach be regarded as a full substitute, making a European Clearing superfluous and useless. First of all, the setting up and implementation of a fully satisfactory IMF system will probably require several years of negotiation and experimentation. Secondly, the management of a world-wide monetary clearing system, and particularly the investment of the large funds derived from its operation, will present enormous administrative and political hurdles, which can best be surmounted through some decentralization of the Fund's decision-making process. Finally, the high degree of economic and political interdependence of the European coun-

tries<sup>4</sup> and their experience of past cooperation are likely to make feasible far more extensive regional trade liberalization, credit commitments and policy harmonization among them than could conceivably be negotiated and implemented on a world-wide level.

The practical feasibility of a European Clearing Agreement, however, is intimately bound up at this stage with the renewal of OEEC negotiations for a European Free Trade Area or Economic Association. Persistent conflicts of views subsist in this respect and make the final outcome highly uncertain. The French protectionist objections which contributed so much to the breakdown of past negotiations may gradually abate if the remarkable success achieved to date by the French monetary and exchange readjustments of last December are confirmed and consolidated. The resurgence of French nationalism today, and possibly of German nationalism tomorrow, may also weaken the political unity objectives of the six countries of the European Economic Community and remove other sources of opposition to a broader, but looser, European Economic Association. On the other side of the Channel, influential circles are already arguing in favor of a full-fledged accession of the United Kingdom to the European Economic Community itself, as it stands today.

None of these trends, however, is sufficiently pronounced to permit any easy prediction of future developments. The European Economic Community exists, not only through the measures and institutions provided for in the Rome Treaty, but also through the myriad of decisions taken by individuals and firms—within and outside the Community itself—to adjust their economic activity and investment plans to the new horizons opened by it. Vested interests will increasingly combine with political ideals to resist any dilution of the six countries' progress toward economic integration and federal unity.

The most realistic and constructive solution of these dilemmas would seem to lie in a parallel drive toward both sets of objectives. Whatever degree of cooperation and liberalization can in fact be achieved among the seventeen OEEC countries should be exploited to the full, but without being allowed to develop as a brake on the closer integration which can realistically be aimed at within the European Economic Community. The gradual adaptation of our legal economic institutions to the facts of international economic

4. About three-fourths of the OEEC countries' total exports are directed to each other and their overseas monetary areas.

interdependence can be carried forward most easily and successfully if we recognize the complementary—rather than the competitive—role that may be assigned to overlapping regional groupings in this respect.<sup>5</sup> The six countries of the Community have indicated their readiness to accept a far closer integration than would be acceptable to the seventeen countries of OEEC, just as the latter may accept broader and firmer commitments to each other than they would be ready to extend to the world at large through GATT or the IMF.

The ensuing discussion of monetary integration among the six countries of the European Economic Community is based on this philosophy. The exact line of demarcation between the institutions of the Community and those of a future European Economic Association cannot be predicted at this stage and should, in any case, fluctuate over time as the future success of integration policies prompts the acceptance of closer commitments and surrenders of sovereignty by the seventeen OEEC countries as well as by the six Community countries.

5. I have discussed these vital policy issues more fully in the last two chapters of *Europe and the Money Muddle*.

## CHAPTER 6

# *Monetary Integration in the European Economic Community*

The adoption of the IMF and EMA reforms suggested above would go a long way toward providing the European Economic Community with a stable monetary framework and facilitating the adoption of liberal policies by the Community toward the rest of Europe and toward the outside world. Yet, a number of factors, specific to the Community itself, must be taken into account for the shaping up of its future monetary policies and institutions.

First of all, the commercial commitments of members have already been negotiated and spelled out in considerable detail in the Rome Treaty, together with a number of other provisions designed to harmonize competitive conditions throughout the Community.

Secondly, these commitments are far more drastic and rigid than those which are likely to be negotiated within the broader framework of GATT or the IMF, or even of the OEEC group as a whole. Correspondingly stronger commitments in the monetary and financial fields will be necessary to ensure a coordination of the members' internal policies sufficient to preserve long run equilibrium in their balances of payments without resort to trade and exchange restrictions outlawed by the Rome Treaty.

Thirdly, a further evolution of the Community's monetary institutions may possibly be called for, in the long run, if the success of the economic integration measures already accepted encourages further progress toward political, as well as economic, integration among the six countries of the Community. The institutional framework to be adopted in the early stages of the Community's life should be flexible enough to facilitate, rather than hamper, such an evolution. On the other hand, the tasks already assigned to the Community's authorities by the Treaty of Rome are so vast and formidable as to deserve their full attention and energies in the immediate years

ahead. The most elementary wisdom and caution will warn them against any premature injection of controversial and divisive issues relating to hypothetical hopes and far-distant blueprints upon which there does not exist at present a sufficient basis for agreement among the participating countries.

The suggestions outlined below should be read in this light. Some of them may be immediately relevant and applicable, while others could only be negotiated and implemented if a protracted period of successful experimentation with less ambitious aims and techniques of integration induces the six countries to push further ahead the gradual merging of their separate administrative and political powers and responsibilities for monetary management.

#### *Monetary Integration through the Disciplines of the Market*

Proponents and adversaries of economic integration generally agree on one point: a real integration presupposes the acceptance by member countries of substantial surrenders of national sovereignty. Incontrovertible as it is, this observation also suggests a totally misleading interpretation of the political options actually available to the national authorities of a country. National sovereignty is always subject to stringent limitations, resulting from economic imperatives and independent of any legal integration agreements or international commitments. One of these imperatives, of particular relevance to the issues to be discussed presently, is the unavoidability of overall balance in a country's external transactions. Deficits in current account must necessarily be balanced by capital imports, and surpluses on current account by capital exports, regardless of the national policies pursued.

The authorities of a deficit country must choose therefore among the following alternatives. First of all, they may be able to finance these deficits by drawing down international assets previously accumulated by the country, but only to the extent that such assets exist and—in the case of private assets—only insofar as their liquidation can be effectively controlled or influenced by the national authorities. Alternatively, they may be able to finance the deficits through the importation of foreign capital, but only within the limits resulting from the foreign lenders' willingness to lend and from the acceptability of the conditions, financial and political, attached by them to these operations. The maximum size of the

current deficits will thus be unavoidably limited by the maximum size of these feasible capital imports and liquidation of assets.

Beyond this, the national authorities cannot escape limiting the deficits to the level of available finance. In the absence of any international commitments, three methods—and three methods only—will be open to them. The first will be to modify their international monetary policy—in the broadest acceptance of this term—in such a way as to adjust the country's overall demand for goods and services to its productive capacity *plus* the excess imports whose financing can be assured by the means outlined above. This may not suffice to restore external equilibrium at high levels of employment and economic activity if the relation of internal costs to costs abroad is such as to dampen export demand and stimulate an excessive demand for imports. The readjustment of cost disparities would require in this case either a reduction of internal cost elements—especially wages—or, more probably, a lowering of exchange rates. This may be avoided, however, at least temporarily, through export subsidies, increases in import duties, or quantitative trade and exchange restrictions.

International agreements will usually involve some sacrifice of sovereignty with respect to the use of subsidies, of tariff and other restrictions, and possibly of exchange rate readjustments. On the other hand, they will also guarantee the country against the shocks to its economy resulting from the resort to similar techniques by its trading partners. They may also enlarge the scope of available external financing through official credits, mutual aid, or merely the stimulation given to private capital imports by the guarantees provided against exchange restrictions or devaluation. The limited sacrifices of sovereignty involved in integration agreements may therefore be offset, or far more than offset, by the opportunities which they offer to protect the country's export markets and to attract additional capital to finance temporary, or desirable, deficits on current account.

This is all the more true as the internal policy readjustments which may be required for the implementation of the country's commitments to trade liberalization and exchange rate stability are in any case economically desirable and even unavoidable in the long run. Trade and exchange restrictions, and even exchange devaluation, offer only a temporary escape from the economic imperatives to which any country is subjected, irrespective of its legal inter-

national commitments. Restrictions may be used to adjust a country's import level to its export proceeds, but persistent inflationary policies would reduce the latter to a mere trickle in the end, because of their impact upon the country's internal prices and production costs. Devaluation would become inescapable at some point to restore an export level sufficient to finance even the most essential import needs. But again the internal prices increases and external currency devaluation brought about by a failure to readjust persistent internal inflationary policies would inevitably lead in the end to a total monetary collapse.<sup>1</sup>

One of the main effects of the trade and exchange commitments explicitly spelled out in the Rome Treaty would therefore be to accelerate the unavoidable impact which market disciplines would ultimately exercise anyway upon a deficit country's policies. The gradual elimination of tariff, trade, and payments restrictions among members, and the adoption of a common, uniform, commercial policy toward non-members will make it impossible for a deficit country to resort to restrictions as a means to balance its external transactions.<sup>2</sup> Exchange rate readjustments are not entirely ruled out and might even be recommended at times by the Commission to overcome deep-seated maladjustments in a country's balance of payments and competitive position. Yet, repeated resort to exchange rate devaluation to offset the incidence of persistently inflationary policies would clearly be incompatible with the Treaty's objectives, and would lead to frequent—even if temporary—distortions in competitive conditions, unacceptable to the country's trading partners. Each Member State is committed to "treat its policy with regard to exchange rates as a matter of common interest" (Article 107) and to "pursue the economic policy necessary to ensure the equilibrium of its overall balance of payments and to maintain confidence in its currency, while ensuring a high level of employment and the stability of the level of prices" (Article 104).

1. I cannot resist the temptation to quote here the following lines from a comedy of Jacques Deval: "Qui croit fair son destin est seulement attaché à une corde plus longue . . . Mais au bout de la corde, . . . nous faisons tous librement ce qu'il était fatal que nous fassions." Countries will most often adopt "freely" in the end the very policies which international agreements would have "forced" them to accept more promptly.

2. Although escape clauses allow a country to resort unilaterally to emergency measures in certain cases, the Executive of the Community may impose by means of a qualified majority vote the modification, suspension or elimination of these measures, without the assent of the country concerned.

The final outcome of these Treaty provisions would therefore be to accelerate and strengthen the impact of traditional market forces upon internal policy readjustments for the countries in deficit. The surplus countries, however, are not subject to similar market pressures and financial limitations. They are always free to offset the internal expansionary impact of their surpluses by "neutralization" or "sterilization" policies. By choosing to do so, and refusing simultaneously to finance their surpluses by capital exports, they may throw upon the deficit countries the whole burden of the internal readjustments necessary to the restoration of equilibrium in the international payments pattern. This "deflationary bias" of the gold standard has often been exaggerated by Keynesian economists, and seems indeed more than compensated today by the "inflationary bias" exercised by pressure groups upon many countries' monetary and fiscal policies. The fact remains, however, that if the harmonization of the member countries' internal policies—*implicitly* required for the observation of the *explicit* clauses of the Treaty relating to restrictions and exchange rates—were left entirely to the disciplines of the market, the latter could only enforce a downward alignment of the more inflationary, or less deflationary, countries upon the less inflationary, or more deflationary, ones. The general pace of expansion of the Community would, in this case, inevitably be set by the least expansionary countries. This is precisely the reason why the sweeping liberalization commitments of the Rome Treaty would have been unacceptable and unnegotiable in the absence of complementary provisions on mutual aid and policy harmonization.

#### *Intergovernmental Cooperation and Policy Harmonization*

The broad philosophy underlying the Treaty is that the initial acceptance and later implementation of its liberalization commitments are conditioned by parallel and mutual commitments to coordinate national policies in such a way as to preserve long run equilibrium in the members' balances of payments at high levels of economic activity and employment and stable levels of prices. This philosophy is embedded in various Treaty articles, but its concrete implications are generally left to be worked out, in *ad hoc* fashion, by the institutional organs of the Community.

Article 105 requires the Member States to "institute for this purpose a collaboration between the competent services of their administrative departments and between their central banks. . . .

In order to promote the coordination of the policies of Member States in monetary matters to the full extent necessary to the functioning of the Common Market, a Monetary Committee with consultative status shall hereby be established with the following tasks:

—to keep under review the monetary and financial situation of Member States and of the Community and also the general payments system of Member States and to report regularly thereon to the Council and to the Commission; and

—to formulate opinions, at the request of the Council or of the Commission or on its own initiative, for submission to the said institutions."

The authority and effectiveness of the Monetary Committee are likely to be very much enhanced by its composition, realistically made up of high-ranking officials from both the Ministry of Finance and the Central Bank of each of the participating countries.

Article 108 establishes the procedure to be followed when actual or prospective balance of payments difficulties of a Member State are likely to prejudice the functioning of the Treaty. The Commission must, in such cases, examine without delay the situation of such a State and the action taken by it. "It shall indicate the measures which it recommends to the State concerned to adopt. If the action taken by a Member State and the measures suggested by the Commission do not prove sufficient to overcome the difficulties encountered or threatening, the Commission shall, after consulting the Monetary Committee, recommend to the Council the granting of special assistance and the appropriate methods therefor. . . . The Council, acting by means of a qualified majority vote, shall grant mutual assistance; it shall issue directives or decisions laying down the conditions and particulars thereof. . . ."

Finally, if all these measures prove insufficient, "the Commission shall authorize the State in difficulties to take measures of safeguard of which the Commission shall determine the conditions and particulars." Article 109 authorizes Member States to take such measures "provisionally" if a sudden crisis occurs and if decisions are not reached immediately with respect to mutual assistance.<sup>3</sup> In either case, however, the Council may, by means of qualified majority vote, force the State concerned "to amend, suspend or abolish the measures of safeguard referred to above."

3. Such independent action by a Member, however, can no longer be taken after the end of the transitional period with regard to its trade with non-member countries.

## 6. INTEGRATION IN EUROPEAN COMMUNITY

These meetings and consultations may reasonably be expected to exercise in time a growing influence upon the necessary harmonization of member countries' internal policies. The views or recommendations they may express in this respect, however, are in no way binding. Divergencies of national policies may therefore persist up to the point where market forces themselves compel deficit countries to readjust their policies, as the exhaustion or near-exhaustion of their monetary reserves make it impossible for them to finance further balance of payments deficits. Mutual aid credits may postpone this day of reckoning, but such credits can only be granted "by other Member States, subject to the agreement of the latter." Case may therefore arise when mutual aid financing is unanimously recognized as desirable and urgent, but may be delayed unduly, or even blocked, by lack of agreement about the most appropriate sources of such financing. This would be most likely to induce recourse to the Treaty's escape clauses, unnecessary otherwise, and highly detrimental to all concerned.

A more effective advance planning of mutual assistance financing would seem highly desirable from this point of view alone. It might also help give more weight to the Community's recommendations for policy harmonization and facilitate the gradual acceptance of prescriptive criteria, agreed to in advance, and delimiting the respective scopes of independent national action and minimum harmonization requirements in the broad field of monetary and financial policies. Such *ex ante* harmonization would obviously be far preferable to mere *ex post* harmonization adopted only after considerable damage has been done, and under the pressure of an acute crisis in member countries' balances of payments.

The suggestions outlined below are directed at these two problems. Once again, however, they raise delicate issues on which agreement could not be reached easily without protracted studies and reflexion. Fortunately, the strong reserve and balance of payments position which now characterizes all the Community countries gives them ample time for such consideration.<sup>4</sup> There is little doubt that further agreements will have to be concluded in the future to

4. The monetary reserves of the six countries, as reported in *International Financial Statistics*, have risen from \$3.3 billion in 1950 to \$10 billion in 1957 and \$12.7 in 1958 and their gold and dollar holdings have increased by \$2 billion in 1958 alone, from \$8.8 billion to \$10.8 billion. The six countries together have had current account surpluses with the rest of the world, ranging from \$600 million to more than \$1 billion a year, in every one of the last six years without exception.

harmonize the monetary institutions of the Community and its international payments machinery with the far-reaching commitments already accepted by it in the field of commercial policy.

#### *A European Community Reserve Fund*

The plan previously outlined for a European Clearing House or Reserve Fund would be particularly adaptable to the needs of the European Community. Minimum deposits with a European Community Reserve Fund could provide the easiest and most rational source of financing for mutual credit assistance without endangering in any way the liquidity requirements of the lending countries.

If minimum deposit requirements were to be calculated on this basis alone, a 10 per cent level in relation to gross monetary reserves would endow the Community with an initial working fund of about \$1.2 billion, ample to meet any conceivable needs for a considerable time to come. It would be desirable, however, though not essential, to foresee from the beginning gradual increases in this ratio, and this for two reasons. The first is to streamline the relationships which might later be established with a reformed IMF or with the European Clearing House envisaged in the preceding chapters of this book. The Community should ideally participate in either or both of these two institutions as a single unit rather than as a separate collection of individual countries. International credit needs of its members should normally be handled and financed by the Community itself, and involve no transactions with either the IMF or the European Clearing House. The need for such transactions would arise only if the Community Reserve Fund ran short of non-member currencies, or if non-member countries ran short of Community currencies, and if these disequilibria called for legitimate cushioning finance rather than for—or in conjunction with—corrective policies on the part of the countries concerned.

Such a scheme of organization would help decentralize the complex negotiations involved and keep in the hands of the Community itself the leverage necessary to promote the desired harmonization of its members' monetary, financial and economic policies. Deposits with a reformed IMF or with a European Clearing House should thus be maintained by the Community Reserve Fund itself, rather than separately by each of the participating countries. The Community Reserve Fund would, however, have to be increased in such

a case beyond the level mentioned above, so as to enable it to maintain the required deposits with the IMF or the European Clearing.

The institution of such a Fund would not entail, of itself, any new and spectacular step toward supranational mechanisms in the monetary field. Its methods of operation could be substantially similar to those suggested above for a wider OEEC Clearing House, except insofar as the Rome Treaty already provides that mutual assistance may be granted by a qualified majority vote of the Council.

Yet, it would be desirable to organize the Fund in such a way as to facilitate some later and gradual shifts of authority and responsibility, in the monetary field, from national institutions to Community institutions.

The experience gained in the initial years of operation of the Monetary Committee in the early detection and readjustment of excessive inflationary or deflationary tendencies in the economy of member countries could, for instance, lead to the definition of presumptive criteria, or danger signals, justifying a stronger intervention of the Community to elicit more rapidly the necessary corrective measures and attempt to forestall *ex ante*, rather than cure *ex post*, foreseeable crises in member countries' balances of payments. It is doubtful indeed whether the Treaty could, in the end, stand the strain of frequently recurring crisis of this sort.

The criteria adopted might be based, for instance, on the amplitude and persistency of changes in employment, economic activity, bank credit, public debt, money supply, prices, monetary reserves, etc. They might initially serve merely to bring automatically into motion a special scrutiny, by the consultative organs of the Community, of the policies followed and of the need for action either by the country itself, or the Community, or both. In the course of time, closer integration might be institutionalized through the adoption of similar criteria as ceilings on independent national decisions. National central banks might, for instance, agree to some presumptive annual ceiling on the growth of their internal credit assets in general, or of some special categories of such assets regarded as particularly open to abuses. Transactions beyond the agreed ceilings might have to be specifically approved by the Commission or the Council, acting upon the recommendations of the Monetary Committee.

The provisions discussed so far all refer to a "downward" harmonization of national "inflationary" policies. An attempt should be made

to build up similar safeguards against national "deflationary" policies, affecting unfavourably the balance of payments of other members and slowing down unnecessarily their own rate of expansion. The minimum deposit requirements of members with the Reserve Fund might be raised upon that portion of their monetary reserves which exceeds some pre-agreed benchmark corresponding to "normal" reserve requirements. Deposits widely in excess of such requirements might be subject to funding into medium or long term securities. Provisions might also be made, in such cases, for a levelling down of discount or interest rates in order to encourage desirable credit expansion. Simultaneous increases in abnormally high reserve levels and budgetary surpluses might even ultimately justify directives to the member concerned to either lower taxes, or increase expenditures, etc.

These two issues—*i.e.* the control of "inflationary" or "deflationary" national policies—inevitably raise the problem of defining the desired level of policy harmonization with respect to which these "undesirable" developments can be characterized and measured. Possible divergencies of views among member countries in this respect will necessarily have to be arbitrated here in the light of the development of the balance of payments of the Community as a whole with the rest of the world.

The huge balance of payments surpluses and reserve accumulation of the Community in recent years should make possible the resumption of a relatively fast pace of expansion, together with liberal external trading policies and with a substantial level of capital exports toward the underdeveloped countries, particularly in Europe and its associated monetary areas.

The opposite situation, however, should also be envisaged. Balance of payments deficits with the rest of the world might possibly develop at a later stage as a result of restrictive policies abroad, or of a faster rate of financial expansion in the Community than in the rest of the world. Joint decisions on the part of members would be necessary in this event in order to strengthen their position in international negotiations aimed either at reversing such trends abroad or at obtaining cushioning finance for temporary deficits. They would be even more necessary if the failure of such efforts forced the Community to choose between a slowdown of its own rates of expansion, or a modification of its currencies' parities, or a tightening of its joint tariff, trade and exchange restrictions toward non-members.

Such are the considerations that will have to determine in the end the average expansion pace and monetary policies of the Community, and influence its ability and willingness to grant mutual aid to individual members in difficulty. They are also likely to impose gradually upon its members a more effective machinery for the adoption and implementation of such joint policies than is now contemplated or than is either necessary or possible in the immediate future. A European Community Reserve Fund could become a powerful instrument to bring about the fuller integration of monetary policies that will ultimately be required by the formation of a single trading area, free of internal barriers, and by the conduct of a uniform commercial policy with respect to the external relations of the Community.

#### *Monetary Unification?*

An eventual merger of members' national currencies into a single Community currency can only be regarded as highly hypothetical at this stage, and should in any case be envisaged only as the ultimate step of a monetary integration process. It must be emphasized that its desirability as well as its difficulties are essentially political rather than economic. Economically, indeed, a full currency merger would differ very little from a system of free and stable exchange rates among the national currencies of the participating countries. The discipline and limitations which would be imposed upon national policies would be practically identical in both cases. If anything, full currency unity would make this discipline less, rather than more, stringent because it would stimulate an even larger flow of cushioning capital movements to finance temporary disequilibria. The reason for this revolves, in turn, on the one major difference between the two systems. National commitments to exchange rate stability may always be reviewed and revoked, at a later stage, by the national authorities. Even an international agreement might be modified by common consent or broken unilaterally by a country in difficulties. A currency merger, on the other hand, would be very nearly irrevocable and irreversible in practice. This irreversibility constitutes a strong argument against a premature merger. It would probably be unwise to close the door as fully and definitely to exchange rate readjustments until the full impact of the Rome Treaty's commitments to trade liberalization has been absorbed and until experience has demonstrated the feasibility and success of the co-

ordination of internal monetary and financial policies throughout the territory of the Community.

We have already discussed above most of the institutional reforms through which such coordination should gradually be implemented and consolidated in any case, irrespective of the final step toward currency unity. This final step itself, if not undertaken prematurely, would not raise any great difficulties. Three types of measures would help smooth out the transition.

The first would be to authorize and encourage the use of the European unit of account<sup>5</sup> in all international, and even national, capital transactions throughout the Community's territory. This would contribute to the revival of the capital markets still paralyzed or handicapped today by fears of exchange rate instability.

The second step would be the adoption by all member countries of new basic national monetary units identical in value to the European unit of account. Each currency would still retain at this stage its own separate entity and be issued and redeemed by its own national central bank. Since all six currencies would now be equivalent in value, however, they could easily circulate at par throughout the area of the Community and be accepted in payment outside the issuing country's borders. Foreign notes returned by traders to the central bank of the country in which they had been received in payment would be redeemed by the issuing bank, the settlement being immediately effected through respective credits and debits of the clearing accounts of the two central banks concerned with the Community Reserve Fund. This intercirculation privilege would bear a close resemblance to the old Latin Union which similarly ensured for many years before the first world war the intercirculation of silver coins whose metallic value diverged substantially from their nominal value.<sup>6</sup> Any subsequent exchange rate readjustment would inevitably deprive the currency concerned from the intercirc-

5. See above p. 125 and footnote.

6. This historical precedent would suggest the adoption of national units—and of a European unit—equal to one fifth of the present gold content of the U.S. dollar. This would restore the traditional relationship of most continental currencies to the U.S. dollar, such as was preserved throughout the nineteenth century on the basis of the famous "germinal" franc. If, as now appears likely, the currencies of the Six are finally stabilized on the basis of their present exchange rates, the proposed new unit would be exchanged practically at par for the new "heavy" French franc, at one to ten for Belgian and Luxemburgese francs, at one to 125 for Italian lire, at one to 0.84 for German marks, and at one to 0.76 for Dutch guilders.

lation privilege. This would act as a powerful deterrent to such readjustments and reinforce exchange rate stability as an important goal of economic policy for the six countries of the Community.

The final stage of monetary unification would then merely require the nominal transfer of the outstanding assets and liabilities of the national central banks to a joint European Monetary Authority. This need not involve any radical alteration in the central banking structure of the Community if all the institutional prerequisites mentioned earlier in this paper had been previously fulfilled. The European Monetary Authority could be organized on a largely decentralized basis, retaining the individuality of the present national central banks as operating institutions for the system, just as the twelve Federal Reserve Banks of the United States carry out in practice all the transactions of the Federal Reserve System. Each national bank would continue to manage its own monetary and credit operations within agreed statutory limits, and under the general supervision of the European Monetary Authority. The statutory rules to be adopted would probably include the setting up of national credit ceilings, to be exceeded only with the approval of the European Monetary Authority, of minimum reserve ratios, and other regulatory techniques inspired from present central banking legislations in the Community and abroad, and from the experience acquired by the European Community Reserve Fund and the Monetary Committee.

An equitable distribution of the burden associated with the maintenance of adequate reserve levels of gold and foreign exchange by the Community as a whole would probably require that each national bank observe some minimum prescriptions with regard to such holdings. These prescriptions might be met at the outset through the negotiation of initial, interest-bearing, stabilization loans, at long or medium term, by the low reserve countries, either abroad or with the high reserve countries. Later reserve deficiencies could be met by special advances or investments of the Community Reserve Fund, or by open market transactions in approved securities among the participating banks.

The reader will note that many of the substantive aspects of such a reform would already have been put into operation by the Monetary Committee and the Community Reserve Fund, if the institutional prerequisites to monetary unification had been previously fulfilled. This confirms the view, expressed above, that the real sig-

nificance of monetary unification is political far more than economic. The fundamental problems which should be raised before such a spectacular decision becomes either desirable or possible are:

1) The acceptance of such an irreversible step toward monetary unification as a political goal, dramatizing and consolidating the will of the Six to achieve a full merger of their national economic sovereignties;

2) The development of a sufficient degree of confidence in the feasibility of this objective, on the basis of protracted experience with a *de facto* harmonization of national policies, the success of which would have been demonstrated by the full observance of the members' liberalization commitments together with the maintenance of exchange rate stability among their separate currencies;

3) The institutionalization of the anonymous market "discipline" involved in this *de facto* harmonization, through administrative rules and procedures, agreed to among members, particularly with reference to the monetization of internal credits by the banking system.

Monetary unification must be conceived therefore as the crowning step of the six countries' integration policies. It should guide and inspire such policies, but its premature adoption would involve enormous risks of setbacks which might be fatal to its consolidation and ultimate success.

## Summary and Conclusions

1. The European convertibility decisions of December 1958 mark an important step forward on the long road from the international monetary chaos of the last decades toward a new international monetary order. Of and by themselves, however, they merely return the world to the unorganized and nationalistic gold exchange standard of the late 1920's. The utter irrationality of such a system, and its extreme vulnerability to unfavorable developments in the few "key currency" countries on which it rests, were unanimously denounced by all economists at that time, and the wisdom of these warnings was quickly and catastrophically demonstrated by the collapse of the gold exchange standard a few years later, in 1931.

Inadequate gold supplies are supplemented, in such a system, by a growing accumulation of *national* key currencies as *international* reserves. Such accumulation inevitably centers on the "safest" currencies of major creditor countries and results in "unrequited" capital imports by them. The very countries that should lend to the others are thus unwittingly borrowing short term capital from them. These capital movements do not, by themselves, relieve the gold shortage, but merely disguise it as a shortage of the key currencies in question. In order to contribute to the needed expansion of world liquidity, they must stimulate additional matching capital exports by the key currency countries, or a contraction of their surpluses on current account. Either of these reactions, however, cannot but lead to a progressive and persistent deterioration in their net reserve position up to the point where their currency no longer appears as the "safest" for reserve investment by other countries. The consequent slowdown, cessation, or reversal of the accumulation of key currencies as world reserves then brings back to the fore the underlying gold shortage problem and imposes at the same time difficult balance of payments readjustments upon the center countries of the system. Internal devaluation, currency devaluation, or trade and exchange restrictions will be the main choices open to them, will tend to spread from

the center countries to the rest of the world, and may be further aggravated by speculative capital movements culminating in a financial panic à la 1931, or/and a relapse into bilateralism.

The recent deterioration of the United States balance of payments, the persistent weakness of the dollar on the exchange markets, the huge gold losses of 1958 and the re-awakening of protectionist forces in the Administration and the Congress would fit this analysis. Heed should be paid to these ominous portents of future trouble before the crisis is upon us.

2. The internationalization of foreign exchange reserves under the aegis of the International Monetary Fund has been advocated above as the most logical solution of this problem. It would facilitate the adjustment of the Fund's lending operations to the legitimate liquidity requirements of an expanding world economy, and help stabilize the world monetary system against the vicissitudes of national monetary management in the present key currency countries. Concrete measures have been proposed to safeguard such a truly *international* gold exchange standard against the inflationary bias which caused the rejection, fifteen years ago, of the broadly similar proposals of John Maynard Keynes.

3. A workable and viable system of international monetary convertibility will also depend, tomorrow as it did yesterday, on an ample provision of cushioning capital to finance temporary disequilibria, and on the correlative acceptance and implementation of a coordination of internal financial policies sufficient to preserve long run equilibrium in each country's overall balance of payments. The internationalization of foreign exchange reserves would help provide this financing and give the International Monetary Fund the necessary leverage to promote such harmonization.

4. Convertibility cannot be meaningfully defined for policy purposes, except as a relative concept whose ultimate culmination would imply the total surrender of national sovereignty by member countries over all forms of trade and payments restrictions, and even over exchange rates. Such surrenders are utterly inconceivable today in favor of a mere nineteenth century *laissez faire*, unconcerned with national levels of employment and economic activity. The negotiation and implementation of negative convertibility commitments are inseparable from the parallel negotiation and implementation of positive integration commitments among the countries concerned. National policy instruments cannot be thrown away. They can only

be traded against international, or supranational policy instruments adequate to serve the broad objectives of economic policy in the modern world.

5. The political, administrative, and psychological obstacles to full integration dictate a flexible approach to the problem of convertibility itself. Every opportunity for negotiable and workable agreements should be exploited as fully as possible, both on the world-wide level and on the regional levels. The potentialities of these latter forms of integration have been convincingly demonstrated by the success of OEEC cooperation since the war, by the recent setting up of the European Economic Community, by the continuing endeavors to establish a European Free Trade Area or Economic Association, and by similar proposals for regional integration in other parts of the world.<sup>1</sup> Closer regional agreements of this type can usefully supplement and support the looser agreements attainable on a world-wide level, and pave the way, under favorable conditions, for a complete merger of economic sovereignty among the participating countries. The last two chapters have summarized the main features of the present European Monetary Agreement and suggested that it be strengthened and consolidated into a European Clearing Union or Reserve Fund, in order to provide a viable monetary and payments framework for the extensive trade commitments of a European Economic Association and of the European Community. Such a Fund might, in the latter context, evolve gradually into a Federal Monetary Authority and provide the institutional machinery required for an eventual merger of the six countries' national currencies.

1. The feasibility of such integration agreements outside Western Europe, and the adjustment of their aims and techniques to very different economic conditions, could not be discussed in this study. The reader may find a few introductory remarks to the problem in a paper of mine on "Latin America in World Trade and Payments" reproduced in the *Proceedings of the Fifth Meeting of Technicians of Central Banks of the American Continent*, Bogota (Colombia), 1957.

Postscript

*Initial Reactions, Official And Other*

*1. From My Fellow Economists and from Central Bankers, at the Elsinore Meeting of the International Economic Association, September 2-10, 1959*

The following report, published in the September 26, 1959, issue of *Business Week*, gives some indication of the reaction of academic economists and central bankers to my proposals for a reform of the International Monetary Fund.

(May I, however, disclaim responsibility for the view that inflation is "a dying issue," and that "the world may not have too much longer to worry about creeping inflation." This overdramatizes—very effectively in the context of the conference—the views I expressed about an international liquidity crisis which is far more likely, in my view, to bring in its wake a new spiral of devaluations and of trade and exchange restrictions rather than a wave of deflationary adaptations.)

#### ECONOMISTS GET STORM WARNING

*World conference, debating inflation, is jolted by forecast that real danger is liquidity crisis and world deflation.*

AT THE PRINS HAMLET HOTEL in Elsinore, Denmark—a short walk from that monument to human indecision, Kronborg Castle, the scene of Hamlet's tragic story—economists from all parts of the world met during the first 10 days of September to brood about their common postwar problem—inflation.

But the ghost that came to haunt this conference of the International Economic Assn. was that of a different, even more ominous danger—worldwide deflation.

While the inflation debate was going round and round, day by day, over the familiar arguments, Prof. Robert Triffin of Yale University gave the contending economists a jolt by telling them, in effect, that they were belaboring a dying issue. The world, he suggested, may not have too much longer to worry about creeping inflation. Instead, he predicted real trouble in the next few years over deflation, devaluation, trade and exchange restrictions—the consequences, as he foresaw it, of a coming liquidity crisis.

Triffin had a remedy, though, for the danger he foresaw. He proposed meeting it by revamping the International Monetary Fund—making it into a true central bank for central banks, one that could expand the reserve base for the world's monetary system.

### *I. Inflation Tilt*

The inflation debate turned into a free-for-all, with liberal economists and central bankers leading the opposing camps. The liberal economists denounced central bankers for narrow moralism and stinginess; the central bankers denounced liberal economists, and special interest groups in modern economic society, for moral laxity and profligacy.

*Range*—Some economists contended there was no conflict between price stability and full employment; others called such conflict inevitable. Some maintained inflation was mainly due to cost-push, others to demand-pull. Others blamed both—as Sir Dennis Robertson of Cambridge University, England, put it, “The staglomite of costs meets the stalacite of demand in an icy kiss.”

Gottfried Haberler of Harvard saw the villain behind inflation in the quantity of money; Jacques Rueff of Paris in sloppy government fiscal policy; Edward Chamberlin of Harvard in labor unions; Erik Lindahl, of Uppsala, Sweden, in all of these and business monopolies as well. Lindahl, retiring president of IEA, concluded that price stability must become the paramount aim of national economic policy, particularly in the U.S., on whose dollar all other national currencies depend.

*Frustration*—At the end, there was a sense of frustration and little accomplishment. The association's newly elected president, Prof. E. A. G. Robinson of Cambridge, England, wearily summing up, said, “The atmosphere of these meetings has been over much that of a Calvinist convention, in which we have condemned sin and sinners.”

Many governments today are anxious to do something about inflation, said Robinson, but the real question is one of weapons. “We haven't enough weapons, and those we have aren't satisfactory,” he asserted. He questioned the efficacy of money measures, saying, “I find it difficult to understand how changes in the stock of money are working through to effect the appropriate changes in the flow of demand.”

Robinson agreed with his Polish colleague, Prof. Edward Lipinski of Warsaw, that the world is moving from a competitive arms struggle

to a struggle over competitive economic development. “Those systems will survive,” said Robinson, “which best provide incomes consistently with freedom and justice. We in the West must devise ways by which our systems can show as good growth rates as others.”

The big problem for managers of the world's banking system today, he added, is this: Can they, without forgetting their price-stabilization duties, also make the banking nations pace-making nations?

### *II. Deflation Warning*

Triffin's warning that the real danger ahead is not inflation but deflation resulting from a liquidity crisis got a mixed reception. Outside the meetings, some economists voiced strong support for his views. Others—particularly the central bankers—were more cautious, saying it was impossible at this stage to pass judgment on his diagnosis or his solution. All pledged careful study of the question.

There was little inclination, at any rate, to scoff at Triffin's warning, for his prestige as an economist and monetary expert is high. He fathered the European Payments Union and, more than any other man, negotiated it into existence.

EPU's success in restoring European trade and strengthening European currencies helped pave the way for last year's “dash to convertibility”—but this lessened the need for EPU and led to its breakup. Triffin went on from this point in his paper, entitled *The Gold Shortage*, the *Dollar Glut*, and the *Future of Convertibility*.

*Double Threat*—The new experiment in convertibility, Triffin fears, faces the same two threats that wrecked a similar experiment some 30 years ago.

The first is the difficulty of providing adequate monetary reserves in an expanding world economy. The ratio of the world's monetary gold stocks to imports has fallen from 110% just before World War II to less than 40%. New gold output and Soviet gold sales have added to monetary gold reserves at a rate of only 1½% a year—compared to an annual gain of 5% to 6% in volume of world trade and manufacturing activity. “It is evident,” says Triffin, “that gold alone could not possibly feed the maintenance of adequate reserve levels in an expanding world economy.”

The second—and more immediate threat—results from the first. To palliate the increasing shortage of gold, the world has reconstructed essentially the same gold-exchange system that fell to pieces in 1931. Nations have done this by holding other nations' currencies

—particularly U.S. dollars and British sterling—as international reserves to supplement monetary gold. This makes the world's monetary system extremely vulnerable.

Large-scale conversions of reserves and other liquid assets from one key currency into the other, or from both into gold, says Triffin, "may at any time topple the whole structure, as they did in the early 1930s."

*Liquidity*—A postwar world that has, for so long, been dominated by inflation has almost forgotten what a liquidity crisis means. It's essentially the international version of, say, a company's liquidity crisis—a fear that it can't meet its obligations with cash or nearcash; a fear that the suspicious creditors will move in on it.

Basically, nations hold reserves of gold or foreign exchange for two reasons: as a means of settling short-term deficits in their overall balance of payments and as a backing for their national currencies. As long as the economic weather stays fair and nations are able to keep their balance of payments reasonably under control—especially with the help of foreign aid or long-term loans or capital movements—their reserve base may shrink without causing appreciable trouble.

But if there is a severe shock to the economy of a major country, or a loss of confidence in its currency, nations that have been holding that key country's currency as reserves—as well as persons or companies holding "hot money"—may decide to get out of it. They will shift to what they think is a stronger currency, or to gold, for fear that, otherwise, they might not be able to meet their obligations or that faith in their own currency might weaken. As such fears are transmitted from nation to nation, restrictions on trade and exchange, devaluations and fears of devaluations mean a severe wrench to total economic activity—a push toward deflation—an aggravation of the forces of depression that brought on the liquidity crisis initially. Some economists believe that the collapse of the world's monetary system in 1931 was what turned a severe but essentially typical boom's-end drop into the worst, most persistent worldwide depression in economic history.

*Dollar's Future*—The huge gold losses of the U.S. last year have given rise to "some uneasiness" about the dollar's future, Triffin observed. (Central bankers at the conference, however, proclaimed their faith in the dollar, said they were increasing their gold holdings for reasons of normal banker-like prudence.) But it was not along this line that Triffin saw the danger.

People have realized belatedly, said Triffin, that the excess of U.S. aid and capital exports over the U.S. dwindling current account surplus is now in its 10th year, and has been financed over the last nine years by a combination of gold losses (\$4.2-billion) and increases in foreign dollar holdings (\$9.4-billion). From 1950 to 1957, the U.S. deficit averaged about \$1.4-billion a year; last year it jumped to \$3.3-billion. This year, Federal Reserve economist Arthur Marget told the conference, the U.S. deficit will reach \$4.5-billion. (But he, too, insisted the dollar was just as strong as ever.)

Triffin scotched "excessive fears" sometimes expressed abroad that the U.S. would be unable to redress the situation in time. U.S. policy is starting to shift. U.S. officials are urging European nations to pick up more of the West's defense burdens, step up their own foreign aid and capital exports to underdeveloped countries, drop discriminations against dollar goods.

*How Crisis Will Come*—All this is well and good, said Triffin, but it misses the essential point for the future: "That a successful readjustment of the U.S. over-all balance of payments is bound to bring back to the fore the latent crisis of international liquidity."

Adequate monetary reserves outside the U.S. have been maintained, Triffin calculated, only one-third by current gold production, and two-thirds by the persistent deterioration of the U.S. net reserve position. Therefore, restoring over-all balance in U.S. international transactions would deprive the world of its major source for meeting increasing reserve requirements.

And as this shift occurs, the underlying problem of world liquidity will "once more threaten to slow down or reverse the high pace of expansion maintained since the end of the war in world trade and production."

As the liquidity squeeze develops, Triffin warned, the nations under pressure will have a choice of internal deflation, currency devaluation, or trade and exchange restrictions. These will tend to spread from the major countries to the rest of the world—and "may be further aggravated by speculative capital movements culminating in a financial panic à la 1931."

### III. Can Crisis Be Averted?

Is there a way out of the crisis Triffin foresees? Many have been proposed.

Mark up the price of gold? Walter Gardner of the International

Monetary Fund attacked this idea at Elsinore, said it couldn't be done "without touching off anticipatory speculation on a major scale." Anyway, he said, the extra resources would go mainly to countries already well supplied with gold.

Adopt flexible exchange rates? Triffin thinks this would bring even wilder speculation, and dangerous swings in the structure of rates. He points out that when some countries adopted flexible rates after World War I, the result was a complete currency collapse—as in Germany and Central Europe.

Periodically increase the resources of the International Monetary Fund by getting nations to agree to increase their quotas at the Fund? The IMF's resources are used to aid nations in balance of payments trouble, and thus constitute, in effect, secondary reserves for central banks. Triffin agrees that increases in IMF quotas, such as the one that went into effect Sept. 15, can provide a "useful breathing spell."

But this can't get at the underlying problem, he argues. For basically, the Fund gets its resources out of the U.S. balance of payments—since it is U.S. dollars, not the masses of bolivianos, cruzeiros, rupees, and so on that the Fund hoards, that are in demand. And if the U.S. balance of payments is under continuous pressure, it won't be easy to get Congress to keep on putting up billions of dollars to augment IMF's holdings.

*Triffin's Way*—Triffin's own proposed solution, presented at Elsinore, is fairly radical. His prescription:

Reconstruct the International Monetary Fund. Turn it into a true central bank for central banks. Permit it, by the same process of creating loans and deposits that any bank employs, to expand continuously the reserve base for the world's monetary system. Make deposits at IMF into a new international medium—the counterpart of gold reserves, and a substitute for national currencies as reserves.

Triffin spelled out his proposal in a paper to be published, together with the full Elsinore proceedings, by Macmillan & Co., Ltd., in London and St. Martin's Press in New York. He has added still more details in two articles this summer in the *Quarterly Review* of the Banca Nazionale del Lavoro, of Rome.

Here are the main provisions:

All countries would stop using other countries' currencies as monetary reserves. They would be required to keep on deposit at IMF minimum proportion of their total national reserves, including both

gold and foreign exchange. If their deposits of foreign exchange (including balances accruing to their account from foreign trade) exceeded the requirement—possibly 20% of their total reserve—they could exchange Fund deposits for gold.

Reserve deposits at IMF would be just as usable as gold in international settlements. IMF deposits would carry exchange rates and convertibility guarantees that would make them, says Triffin, safer for reserve investment than any national currency holdings. They would earn interest at a rate determined by IMF earnings on its loans and investments—thus combining the security of gold reserves with the earning incentive of foreign exchange holdings.

*Meeting Objections*—Triffin's plan has a basic similarity to the original Keynes plan at Bretton Woods for IMF. But Triffin attempts to deal with the two basic objections to the Keynes plan that led to its rejection 15 years ago—and have forestalled all subsequent attempts to revive it: (1) that it would lead to continuous inflation, as IMF loans and deposits continuously grew faster than world output and (2) that it would mean the surrender of national economic sovereignty to an international body. Triffin tries to deal with these objections (1) by setting a narrow limit on annual increases of IMF loans and deposits, to prevent the reserve base from growing faster than real trade and production; and (2) by restricting IMF's supernational authority and leaving plenty of room for nations and regional groups to set their own economic policies.

Nevertheless, Triffin is not optimistic about the chances that governments will eagerly leap for his scheme. He is aware that the cautiousness and conservatism of central bankers, and the strength of nationalism almost everywhere, work against any such quick acceptance.

2. *From Her British Majesty's Committee on the Working of the Monetary System (London, August 1959)*

Professor A.C.L. Day brought before the Radcliffe Committee on the Working of the Monetary System the suggestions presented above for the absorption of sterling balances by the IMF and the holding of international reserves by all countries in the form of Fund deposits. Mr. Day himself gave strong support to both of these suggestions which we had amply debated together during a visit of his to Yale University in the spring of 1959.

As shown by the following extracts from the Committee's Report, the Committee was reluctant to accept the first of these recommendations, but strongly endorsed the latter.

*Extracts from the Report of the Committee on the Working of the Monetary System (pp. 242-248)*

*The Problem of International Liquidity*

664. We drew attention at the beginning of this chapter to the twofold threat to the stability of the United Kingdom economy arising out of its dependence on foreign trade: there is both a direct threat due to fluctuations in export markets and in sources of supply of imports, and an indirect pressure on domestic activity because of the need to balance accounts over the whole range of international payments. It is very much in the interests of the United Kingdom, therefore, that the world economy itself should be as stable as possible and that, if fluctuations do occur, they should not automatically spread from one country to another for lack of adequate international liquidity. Just as a sudden contraction in one sector of the United Kingdom economy may precipitate a slump in other sectors unless they have adequate reserves or access to credit, the same danger exists on an international scale; and there is the same need for offsetting action to bring expansionary forces into play. There is, however, no international monetary authority charged with similar responsibilities and armed with similar powers to those that the domestic monetary authorities have.

665. When the Macmillan Committee examined this problem

thirty years ago, the line of advance which it recommended lay through closer co-operation between central banks to maintain the stability of international prices. That Committee did not envisage the creation of fresh international institutions but suggested, rather incidentally, that balances held with the Bank for International Settlements might be reckoned by central banks as the equivalent of gold. This suggestion was one of several designed to economise in the use of gold and introduce more elasticity into the relationship between gold and the money supply.

666. Co-operation between national monetary authorities has become much closer and more highly organized over the past generation. There have been regular consultations at the B.I.S. between European central bankers throughout most of the past thirty years. The monetary authorities of the countries of Western Europe are also assisted in harmonising their policies by the discussions that take place in the Organisation for European Economic Co-operation: the operations of the now defunct European Payments Union and of the European Monetary Agreement by which it has been succeeded have obliged them regularly to take stock together of their common problems. There has also been created, in the International Monetary Fund, an international organisation which, although occupying a more subordinate position in post-war monetary reconstruction than its founders had hoped, may yet come to play the part of an international central bank.

667. The distinguishing feature of the monetary situation after the war, however, was not so much the international machinery by which it was handled as the willingness of the largest creditor country, the United States, to take the action necessary to prevent the problem of international liquidity from becoming acute. The pattern of settlements that emerged after the war was one involving heavy dollar deficits in nearly all the major European countries; and these deficits could only have been eliminated, in the absence of large loans and grants, by arresting and perhaps reversing the rapid industrial recovery that was in fact achieved. The acute shortage of capital, to which we referred in Chapter I, would have persisted much longer, and with crippling effects on the economy of Europe, had the leading industrial countries been forced to rely on their own savings and reserves. However much they had sought, by discrimination or in other ways, to limit their imports from North America, and to make more use of what each could offer the others, the pressure on real

resources would have been intensified by the need to wipe out external deficits, and might have been further increased if import restrictions had deprived them of the materials and equipment that industrial reconstruction required. Outside Europe there would also have been a slowing down of activity, both because it would have been impossible to allow such free access to sterling balances and because some at least of the markets in Europe would have contracted.

668. So long as the United States stood ready to ensure, by means of programmes of economic aid to European and other countries, that dollar settlements could be made without aggravation of international illiquidity, the principal threat to equilibrium in international transactions was held in check. It was less certain that natural forces would in time restore balance between North America and the rest of the world. Between the wars the rest of the world for various reasons experienced considerable difficulty in balancing accounts with the United States, and towards the end of the period there was a large drain of gold to that country, because of the flow of hot money in search of security. This drain re-emerged immediately after the war; it was halted by massive aid from the United States, but it was not clear whether the underlying position was such that, if aid were to cease after a few years, the necessary adjustments could be made without sacrifice to the level of economic activity. These doubts disposed the United Kingdom, in common with many other countries, to take special steps to improve her balance of payments with the United States and to impose restrictions on expenditure in dollars. Imports likely to involve a dollar outlay were made subject to discriminatory restrictions, while exports for which payment was made in dollars were given special encouragement. The exchange control regulations also differentiated between transactions involving settlement in dollars and transactions involving settlement in sterling, and limited the convertibility of sterling into dollars and other currencies.

669. We discuss later the issues involved in sterling convertibility. What we wish to emphasise here is that inconvertibility makes sense only in the context of international imbalance. It is also appropriate, in our view, only if the imbalance is stubborn and protracted. If it is temporary, and not such as to call for large structural adjustments, it is preferable to make use of reserves and external credits rather than to apply discriminatory measures which are both slow to take effect and difficult to reverse. This presupposes, however, that international

reserves are adequate and well-distributed and that external credits are freely available to countries whose economies are sound and whose difficulties do not result from their own mistaken policies.

670. We have already argued that the first of these presuppositions is untenable. Although the reserves of the United Kingdom have improved in recent years, they are far from adequate in relation either to the swings in the United Kingdom's balance of payments that are liable to occur or to the balances in sterling that can be drawn upon at call. The reserves held by other countries are also, in the aggregate, much lower in relation to the value of international transactions than twenty years ago, and are failing to keep pace with the expansion in trade and payments.

671. Total international reserves immediately before the war were abnormally high in relation to the value of world trade.\* They had more than doubled in dollar value over the preceding decade . . . and were actually in excess of the total annual value of commodity trade; even if United States reserves and United States trade are omitted, the ratio in 1937-38 works out at no less than 63 per cent.† This ratio fell heavily during the war, largely because goods rose in price while gold did not, and a much higher proportion of the reserves held outside the United States was held in sterling, which was no longer freely convertible into gold. In 1948 the world excluding the United States held less gold measured in weight, and not a great deal more measured in dollars, than twenty years previously; on this base it had to support twice as much trade in terms of dollars. In the past ten years this position has changed greatly. The ratio of reserves to imports has declined from 45 per cent to 36 per cent (or to roughly the same proportion as in 1928); but this does not represent a straightforward deterioration. On the one hand the dollar value of trade has again doubled; on the other hand the reserve position has been fortified by a rather less rapid increase in gold holdings and a simultaneous improvement in the liquidity of reserves held in foreign exchange. Whereas these reserves consisted in 1948 mainly of inconvertible sterling, they now consist as to over 50 per cent of dollars, while the remainder is fully convertible into dollars. Total international reserves (excluding the Soviet bloc) have risen from \$13,000 mn. in 1928 to \$54,000 mn. in 1957, and gold holdings

\* In this and the following paragraphs "the world" must be taken as excluding the Soviet bloc.

† *International Reserves and Liquidity* (IMF), p. 26.

alone have risen from \$10,000 mn. to \$37,000 mn. over the same period.

672. It is possible to argue, as some witnesses have done, that the central fact in the situation is the failure of the world's supply of monetary gold to keep pace with the increase in the value of international trade. In the past twenty years the increase in the gold reserves of all countries has been less than 50 per cent, while the value of international trade has increased fourfold; the stock of gold has been rising at about 2 per cent per annum, while international trade, even at constant prices, has been rising at a rate between two and three times as great. It is perhaps natural, therefore, to regard a substantial increase in the world price of gold as an appropriate method of securing a more satisfactory level of international reserves.

673. A doubling of the price of gold would undoubtedly do more to effect an immediate improvement in the reserves of the United Kingdom, and to strengthen the position of the sterling area as a whole, than any other proposal that has been put before us. It would also be of considerable advantage to those members of the sterling area who are large exporters of gold and have felt themselves handicapped by the constancy of its price during a period of rapid inflation. We agree that there are circumstances in which a large increase in the world price of gold would be a desirable measure, but we do not regard such an increase as either immediately necessary or the most hopeful approach to the problem of international liquidity. The advantages do not depend entirely on arithmetical calculations; but the countries whose reserves are least adequate must, almost by definition, be countries with relatively low stocks of gold, so that any increase in price would be of little immediate assistance to them. At the end of 1958 the gold holdings of the United States, Germany and Switzerland were about \$25,000 mn., while the gold holdings of other countries (excluding the Soviet bloc) amounted to about \$13,000 mn. and their holdings of foreign exchange to about \$12,500 mn. If the price of gold were doubled, the addition to the reserves of gold and foreign exchange held by these other countries would rise by about 50 per cent, while the reserves of the three countries mentioned would be roughly doubled. The existing distribution of reserves would thus be altered very much in favour of the countries that are most amply provided. If this disposed those countries to adopt policies that made it easier for the rest of the world to add to its reserve, the step would have much to recommend it. But there is no

indication at present that it would have this effect, or that other measures which we discuss below would meet with less acceptance.

674. There is, moreover, an important disadvantage that would result from an immediate rise in the price of gold. This is the uncertainty that would surround future changes in the price of gold. A single large change now would point to further periodic changes at later dates, not in response to changes in mining costs but as a means of bringing reserves into line with the expansion in international transactions. On each occasion a public debate would precede the final decision, and would introduce strong speculative influences which are highly undesirable in matters of such international importance.

675. It seems to us preferable to make use of the machinery created at the end of the war for dealing with problems of international liquidity. The most important instrument for this purpose is the International Monetary Fund. Each member of the Fund subscribes to the assets of the Fund an agreed quota, in gold and in its own currency, and any member can, with the agreement of the Fund, draw on it up to a maximum of 125 per cent of this quota. The existing resources of the Fund are small in relation to the magnitude of total central bank reserves and they can be drawn upon with far less freedom. But they can, if necessary, be increased and they are in fact in course of being increased by 50 per cent. Moreover they can be applied at key points in the world's financial structure, where they can have an effect out of all proportion to their magnitude.

676. A good example of such support by the Fund was the assistance extended to the United Kingdom at the time of the Suez crisis; the drawing of \$561 mn. together with the stand-by credit of \$739 mn. represented a very considerable reinforcement of the United Kingdom's reserves. The drawing and the stand-by credit together were equivalent to 100 per cent of the United Kingdom's quota, and were made available in response to a statement by the United Kingdom Government that strict financial and credit policies would be pursued, that quantitative restrictions would not be reimposed, and that the value of sterling would be maintained. While the right to draw up to the first 25 per cent of a country's quota is almost automatic, countries have to justify by progressively stricter criteria any drawings beyond this amount. The use of the Fund's resources does not allow a country the same freedom of action, therefore, as the use of its own reserves. In our view this should not deter

the United Kingdom from relying upon the Fund and assisting it to play a larger part in the international economy. The community of interests that binds together the members of the Fund requires that members who wish to draw on the Fund should be willing to justify to their fellow-members the economic and monetary policies which they are pursuing and that their fellow-members should refrain from imposing unduly rigorous conditions on drawings.

677. While in its present form the Fund may not be able to deal adequately with the problem of international liquidity, we believe that it already makes an effective contribution which could be further developed, and that it should be a principal object of policy to widen the scope of its operations. We do not make detailed proposals, but there are a number of considerations of importance to which we draw attention.

678. First, the real resources of the International Monetary Fund would be greatly augmented if the currencies at its disposal were all convertible in terms of its Articles of Agreement. Since International Monetary Fund drawings have to be repaid in gold or convertible currencies, and the only fully convertible currency of any importance has been dollars (Switzerland not being a member), it has been natural to seek to draw dollars, and this has limited the amount that could be made available to members. Under conditions of general convertibility the Fund's operations would not be inhibited by this limitation.\* Another possibility, provided that one country did not remain a constant and increasing creditor while nearly all the others were debtors, would be to relax further some of the requirements that at present attend the use of drawing rights in excess of the first 25 per cent of quotas. Countries would be in a position to make fluctuations in their International Monetary Fund drawings take the place of some of the present fluctuations in their reserves. It might also be possible to encourage the holding of central bank reserves with the International Monetary Fund on the understanding that it would be possible to draw freely on these centralised reserves, just as at present sterling area countries can draw on their balances at the Bank of England. Another possibility again would be an arrangement,

\* If all currencies were convertible in the terms of the IMF Agreement, the Fund would in theory, when the increases in national quotas have all been approved, have available to meet drawings the aggregate of national quotas, or about \$14,000 mn. in total. A currency is convertible, however, only if it is free from restrictions on current transactions (other than those approved by the Fund); the resources of the Fund in such currencies at present amount only to about \$2,800 mn.

such as that suggested to us by Mr. Day and referred to in para. 660, for the reserves of sterling area countries to be held with the International Monetary Fund, the United Kingdom undertaking to make the sterling equivalent available to the International Monetary Fund by a series of payments over a period of years. An arrangement of this kind, requiring international agreement, would be extremely difficult to negotiate and does not appear to us likely to be of immediate and substantial assistance to sterling; it might, indeed, oblige the United Kingdom to discharge her external liabilities more quickly than would otherwise be necessary. On the other hand we see great merit as a long-term objective in Mr. Day's further proposal for a transformation of the International Monetary Fund, along the lines originally proposed by the United Kingdom, into an international central bank, with its own unit of account, free to accept deposit liabilities or extend overdraft facilities to the central banks of member countries.

679. All of these possibilities are in large measure dependent, as is convertibility itself, on the preservation of international balance and on a pattern of settlements in which no one country is in an overwhelmingly creditor position on short-term account. In a situation of international imbalance, greater liquidity in any form would be insufficient to allow accounts to be balanced for long, and debtors would be driven to take action to protect their economies by increasingly discriminatory measures. They would have little interest in acquiring from the Fund currencies with which they would be unable to make settlements with the dominant creditor; they would be unwilling to pool their reserves when they saw a run on the Fund in progress; and they would seek to resurrect payments arrangements, such as exist in the sterling area, involving settlement in a currency more easy to acquire. At the same time the reluctance of creditor countries to accede to an increase in the resources of the Fund would be reawakened.

680. It is impossible, therefore, to disentangle the problem of international liquidity from the problem of international balance. Liquidity is needed only to meet a departure from balance. If the departure is seasonal or temporary, it is highly desirable that it should be allowed time to correct itself, through a rundown of reserves or an extension of credit, without destroying the balance of the domestic economy. So long as no one country is a large and persistent debtor or creditor, a succession of deficits and surpluses can be handled

with remarkably small liquid reserves. But if, as has been the normal experience of the past generation, the departure from balance is more profound, and is not immediately self-correcting, the investment in liquidity necessary to see matters through will have to be very heavy, and is unlikely to be made. Merely to double or treble the reserves of all countries will not for long safeguard the weaker countries from the effects of a persistent deficit, and if the weaker countries find themselves in difficulties others may also find their reserves inadequate.

### 3. *From the Joint Economic Committee of the United States Congress*

On October 9, 1959, I was invited by Senator Paul H. Douglas to appear before the Joint Economic Committee during the last week of its hearings on employment, growth and price levels. I was specifically asked, as were all the other witnesses that week, to offer the Committee "constructive suggestions for reconciling and simultaneously attaining the three economic objectives of maximum employment, an adequate rate of growth, and substantial stability of the price level." I testified before the Committee on October 28, 1959.

The debate that followed suggests that the United States Congress might be less unresponsive to bold and forward-looking proposals for a radical reform of the present, unsatisfactory IMF mechanism than generally feared by the Administration and the Fund Management. The very real political difficulties involved may have more to do with the reluctance of political leaders to lead than with the refusal of Congress and public opinion to accept such leadership.

My verbal statement to the Committee—which preceded the debate—may be found on pp. 3-14, above. It also appears in Paragraph 9A of the Committee's Hearings, together with my written statement to the Committee, the text of my paper for the International Economic Association on "The Gold Shortage, the Dollar Glut, and the Future of Convertibility," and the full text of the debate from which the following excerpts are taken.

#### *Excerpts from the Joint Committee's Hearings*

*Representative Reuss:* I will not press you for the name of your anonymous friend in the administration, but I will say this in great seriousness:

I wish that this particular friend of yours in the administration or some other qualified spokesman in the administration had given me last spring, when the Banking and Currency Committees of the Senate and House were acting on the administration's request, the broad total picture which you have given us today. It might have made for a more intelligent and forward-looking legislative approach then we were able to give the matter, in view of the very curtailed and narrow statements the administration has given us.

I will not press for the name of your colleague, because I can see he might not much longer be a member of the administration if you gave his name.

Let me ask you about this problem of tied loans, which you talked about so sensibly, I think, in your written statement. You make the point that to convert our loan program, such as it is, into a tied loan program will be a palliative at best, and the practical results are likely to prove very disappointing.

You go on to say, more than that, there may be retaliation which might leave us worse off than before.

Is that a fair statement?

*Mr. Triffin:* Yes; it is. I would add to that possibly that I can see that one of the actions that is most urgently called for is the participation by Europe in this foreign financing.

I think it will be particularly unfortunate if by our own actions at the moment we induce Europe to offer such financing in the form of tied loans rather than in the form of untied loans.

I think what we have to gain by untied loans from Europe will be much greater than what we can gain really by tying what is not already tied in our own loan programs.

*Representative Reuss:* Would you agree with my view that one of the first requisites for foreign economic policy is to use our utmost effort, much greater effort than we have so far used, to induce the dollar and gold-happy countries of Western Europe, and I will name Western Germany as a prime example of this, to bear a much larger and fairer share of the burden of developing underdeveloped areas?

*Mr. Triffin:* Absolutely. I think many people are urging that policy upon Europe at the moment. I think it is very practical politics.

It is unfortunate that at the time that Europe seems to be on the verge of moving toward such a program we, ourselves, gave them a wrong example by tying our loans, with very paltry results, I think, particularly in the short term.

\* \* \* \* \*

*Representative Reuss:* Let me change the subject now to your equally cogent remarks about gold outflow and the mortgage on our gold stocks retained.

Among other things, you talk there of an unbearable drain on our gold reserves and no doubt you are looking at the point, when you re-

ferred to the chart, where those two railroad tracks cross next spring and somebody drives in the golden spike indicating that now the lien on our gold supply is in excess of the supply.

I would like you to look, if you will, to the reality of the danger of a run on the bank if you want to call it that.

I have heard before this committee, at least one witness, tend to discount that. In fact, I think the witness I have in mind says that if you are going to apply a straight balance sheet analysis to our gold position every bank in the United States would be kind of broke, because there the claims equal the assets.

*Mr. Triffin:* That is a very difficult point. If I may deal with this last observation, I think the situations are extremely different.

If there were a run on the banks in the United States, there is a Federal Reserve system which can always bail them out, and properly in such a case.

So there is a feature in our national banking system which is totally absent in the international monetary system because the Fund could help to some extent, but you can imagine yourself what would be the reaction if we were to ask for a loan from the Fund at the time that there is a "run on the bank."

It would only aggravate matters.

*Representative Reuss:* What kinds of circumstances, psychological and otherwise, on the part of holders of the foreign dollar holdings would have to come about before there would be a mass movement to withdraw?

*Mr. Triffin:* May I point to the fuller written statement which I have prepared, because I also think that that chart can be very easily misinterpreted and too pessimistic conclusions could be drawn from it.

As I say here,<sup>1</sup> there is nothing necessarily alarming or even unusual for a country like ours, in this rough equivalence between our gold stock and these foreign liabilities.

Sterling, as you know, was made convertible last December at a time when the sterling balances were not equivalent to the United Kingdom gold stock, but three to four times larger than the United Kingdom gold stock.

Yet the pound sterling has been doing extremely well ever since.

Therefore, I would be less of an alarmist than some financial writers have been about this problem. I think that basically the strength and weakness of our international position cannot be gauged from any simple formula of this sort.

We should take account, also, of our own short-term and even long-term assets abroad, although we might not be able to mobilize quickly those assets, which are very largely in private hands, at a time when we would need to do so because of the run which you are contemplating.

Moreover, we should also take into account other things. There are also long-term investments on this market by foreigners, and under certain circumstances those assets might be liquidated by them for repatriation to their country or for investment elsewhere, not simply because there is no confidence in the dollar, but again because of mere differentials in interest rates, which I pointed out before to be very important. Finally you could, in other circumstances, I think, if we did nothing to cure the present situation, come to the point where even the U.S. citizens might become alarmed and export capital abroad, and there the sky would be the limit.

Now, I do not for a moment anticipate those developments. I think the situation could be remedied very easily.

Our strength is so enormous that we should not worry unduly about it.

When we speak of a \$4 billion deficit, that figure is slightly exaggerated, because it does not take into account the inflow of long-term foreign capital into this country, but even taking the figure of \$4 billion this is less than 1 percent of our gross national product.

And there is nothing very difficult in remedying that situation. It will take time, however, if we do it the right way rather than the wrong way.

*The Chairman:* As I am not an expert in this field, and my mind moves very slowly, I want to see if I understand your proposal.

Are you proposing that we have an international central bank whose relations with the national central banks shall be parallel to the relationship of the national central banks to their member banks?

*Mr. Triffin:* I think in essence you could describe it like that, and this is exactly the way my proposal was described by a journalist in *Business Week* some weeks ago.

But I do not like to put it that way for only one reason, that the

use of such words is exactly what scares the hell out of central bankers. Those people are very conservative.

*The Chairman:* It does not frighten me at all and I am not as timid as the international bankers or as the international central bankers. I want to know if this is really what you are proposing.

*Mr. Triffin:* It is, essentially.

*The Chairman:* Now, you say that each central bank would deposit 20 percent. Of what?

*Mr. Triffin:* Of its gross gold and foreign exchange reserves.

For us that would be, as of now, 20 percent of \$19.5 billion.

*The Chairman:* How would you equate the foreign exchange of the various countries? With the ratios as of a given day?

*Mr. Triffin:* This would take place continually. That is, each country would always have to keep a certain portion of its total reserves with the Fund.

While now many of them hold a large portion of their reserves with, let us say, the Chase Bank or in Treasury bills, they would now pass this on to the Fund and then the Fund itself would hold these Treasury bills or these deposits with the Chase Bank.

*The Chairman:* Could this be computed in terms of dollars?

*Mr. Triffin:* I think it would have to be, as it is now in the Monetary Fund, a gold dollar. Or it might be something a little more complex.

*The Chairman:* Does this furnish the capital or furnish the reserves for the International Central Bank?

*Mr. Triffin:* It would provide it with a certain amount of lending capacity essentially. It is exactly the same thing as what happens in our national banking system.

It is on the basis of the deposits of individuals in the banking system that the banks can lend and put those funds to use.

On the other hand, the funds which you hold in deposits remain perfectly liquid. You can draw on them whenever you want to; and this would also be true here.

*The Chairman:* Now, suppose that the International Central Bank has \$10 billion in gold and foreign exchange equivalence of dollars, what would its lending capacity be?

Would you have the 100 percent reserve system or a fractional reserve system.

*Mr. Triffin:* It depends on what we mean by "reserves" in this case. Let us suppose that there are \$10 billion of deposit liabilities in the new Fund to the central banks of the world. As against that, the Fund would have in its assets a certain proportion in gold and another proportion in foreign exchange.

*The Chairman:* I understand. That is how the international central bank gets its \$10 billion.

*Mr. Triffin:* That is right.

*The Chairman:* Now, will the International Bank make loans to the national central banks?

*Mr. Triffin:* That is right.

*The Chairman:* What will be the total limit on the loans? Could they only loan out the amount of their reserves, thus having a 100 percent system or a dollar on reserve for every dollar loaned out, or could they, as under our system, loan out a multiple of this—say, a dollar on reserve for every \$6 loaned out?

*Mr. Triffin:* In practice, they would certainly lend; they would be able to lend. It would not be a hundred percent reserve system. The limitations would depend, of course, on the total amount of deposits which are left with them by their customers—that is, by the central banks—and secondly, since the lending capacity that would result from this, Mr. Chairman, could be conceivably very large, I have suggested here, to reassure the people who were properly worried about this inflationary danger, that you would limit by statute in the new agreement the lending power of the institution.

*The Chairman:* Mr. Triffin, I am not deterred by fears. I am trying to understand.

*Mr. Triffin:* Yes.

*The Chairman:* What I am trying to get at is this: Will the international central bank have the power to create additional monetary purchasing power?

*Mr. Triffin:* Yes, I see your point exactly, yes.

*The Chairman:* This does not frighten me, but I want to understand this.

*Mr. Triffin:* It would frighten other people.

*The Chairman:* It might frighten timid central bankers, but it would not frighten sensible people.

*Mr. Triffin:* I don't think it should.

Let me take a concrete example, which I think will make this clear to you.

Suppose that the Fund wants to lend \$10 million, or the equivalent of \$10 million, to some country.

*The Chairman:* Million or billion?

*Mr. Triffin:* I said "million" but make it \$100 million, if you like, or \$500 million. It will write in its assets an additional amount of \$500 million of new assets which is the claim which it now holds against the borrowing country, and it will write in its liabilities an equal amount of \$500 million of new deposits credited to the account of that country. That is what happens in our own banking system.

*The Chairman:* You are starting on the old investment-banking analogy that deposits come first and the loans come later; but commercial banking is of a different type.

The loan comes first and that creates the deposit.

*Mr. Triffin:* No sir, Mr. Chairman; I think I did not make myself clear. I said it would be exactly as in the commercial banks. The Fund would lend first and credit the amount of that loan as a deposit to the borrower. That is exactly what you have in mind.

*The Chairman:* I see. Do you have any reserve ratio which it should maintain? Assume that it has \$10 billion of reserves in gold and foreign exchange, what would be the total it could lend out?

In this country it would be about \$60 billion, because you have roughly a multiple of six.

*Mr. Triffin:* Well, this would be somewhat different. I don't think we could calculate it in the same manner because, while the Fund can always make new loans by creating new deposits, I envisage here that countries, including our own, would probably refuse to accept such an agreement unless there was a limit on the amount of deposits

which they are compelled to leave with the Fund and, therefore, I suggested here that, to start the system at least, countries should be compelled to hold only about 20 percent of their total reserves with the Fund. They would have the right to convert in gold any deposits accruing to them in excess of that amount.

Now, that would expose the Fund to a certain outflow of gold and this would determine the limits of the Fund lending capacity.

In practice—I may say, I have discussed it at great length in an article of mine which I mentioned here<sup>2</sup>—I think it would endow the Fund with considerable lending power for many years to come.

*The Chairman:* But the 20 percent would be something that they could not withdraw.

*Mr. Triffin:* That they could not withdraw, that is right.

*The Chairman:* The question I want to ask is: What is the volume of additional deposits that you can build up on that initial 20 percent which, according to my rough figuring, is somewhere around \$10 billion.

*Mr. Triffin:* That is right; about \$11 billion today.

The amount additional to that would depend really on how the Fund is able to attract deposits and to retain them.

If, for instance, every country tomorrow felt very diffident about this institution and decided to convert into gold everything that they are not compelled to leave with the Fund, this would limit the Fund lending capacity.

*The Chairman:* Let me ask you this question: Would the international central bank have the power of open market operations?

*Mr. Triffin:* Yes, very definitely.

*The Chairman:* This, as a matter of fact, is the way in which the reserves in the Federal Reserve System have built up—not so much by voluntary deposits of the member banks as by purchase of Government securities and the payment for these takes the form of the creation of a deposit in the central bank credited to the banks which hold the accounts of the sellers; is that not true?

*Mr. Triffin:* That is right.

2. "The Gold Shortage, the Dollar Glut, and the Future of Convertibility," *The Banker*, London, January 1960.

*The Chairman:* Congressman Reuss has been edging very close to being convinced that we should expand our reserves and our total monetary stock through open market operations rather than through the lowering of reserve ratios.

Have you thought who should get the profit from the creation of this monetary purchasing power?

*Mr. Triffin:* In the case of this new Fund?

*The Chairman:* Yes.

*Mr. Triffin:* I think it would have to be distributed probably as interest or earnings on the deposits which are left with the Fund.

This is the way in which countries will find it very advantageous to keep reserves there. At the moment they keep large reserves in foreign exchange because that allows them to earn interest, which they do not earn on gold holdings.

You would have to keep the same incentive to have them deposit with the Fund.

*The Chairman:* Now, this is very suggestive and I want to pursue this matter of analogy a little further.

Are you saying that you are trying to prevent runs on countries in the same way, or reduce runs on countries in the same way we have reduced runs on member banks by (a) the creation of a Federal Reserve System and (b) the Federal Deposit Insurance Corporation?

*Mr. Triffin:* Exactly. That is exactly the meaning of it.

At the moment you have about eight to nine billion dollars of reserves held in short-term dollar holdings by foreign central banks alone, not counting private holdings. These can shift at any time from dollars into sterling or gold.

*The Chairman:* In other words, that national monetary systems are now at the mercy of international depositors?

*Mr. Triffin:* That is right.

*The Chairman:* This puts a premium upon the influence of those who hold "hot" money or those who manipulate reserves for political purposes, or people who are anxious to make a fast dollar.

*Mr. Triffin:* Absolutely.

*The Chairman:* Or the people most given to fear.

*Mr. Triffin:* Absolutely.

*The Chairman:* In other words, you say that the national monetary system are now at the mercy of the least dependable elements in the community?

*Mr. Triffin:* I would not go quite as far. They are at the mercy of any elements in the community.

*The Chairman:* The listing of these groups would indicate they would not stand high in any category of socially desirable classes in society.

*Mr. Triffin:* No, but let me say why I say there would be other elements also. There would undoubtedly be some foreign central banks which do not want to speculate particularly, but which are tied by their own legislation in keeping reserves against their own currency. Their currencies are defined in terms of gold and theoretically if they were unwise enough to keep foreign exchange deposits on the eve of a devaluation they would lose money on this and they would be accountable to their own people.

You will remember—and I think this is something which we should keep very much in front of our mind, Mr. Chairman—what happened in 1931, from 1928 to 1931, the hot money which had gone to Britain from the Continent . . .

*The Chairman:* What is your definition of hot money?

*Mr. Triffin:* I would not try to dream up a new definition on the spur of the moment, but I was thinking primarily in this connection of funds which have moved out of their own country primarily because of fears, and justified fears at that time, of currency depreciation in Europe.

Now, in addition to that, you might expand the definition of hot money to include short-term money which seeks a higher return in terms of interest rates.

But the first one is the one about which I am particularly concerned, because I think that there are large amounts of funds of that character which have been building up since the war.

\* \* \*

*The Chairman:* Am I correct in thinking that one reason why you

advocate this is that you think that the present rate of increase in the gold supply is inadequate to maintain growth?

*Mr. Triffin:* Yes.

*The Chairman:* This is 1½ percent a year, roughly?

*Mr. Triffin:* That is right.

*The Chairman:* Though you did not mention this, to raise the price of gold would enrich, I suppose, the Union of Soviet Socialist Republics and South Africa?

*Mr. Triffin:* I discuss this quite at length again in that article and mention quite a number of objections to the proposal to raise the price of gold, including that very one, that the two countries that would benefit from this most would be South Africa and Russia.<sup>3</sup> But there are many other objections also.

*The Chairman:* The first of the countries has the worse racial system of any country in the Western World.

*Mr. Triffin:* Certainly.

*The Chairman:* And the second is certainly hostile to the United States?

*Mr. Triffin:* Exactly.

I think those are the most powerful political arguments against any such proposal.

As I indicate in my article, I think there are also many other objections to it. It is really a red herring.

*The Chairman:* What you are trying to do is to create an international currency through an international agency with an increase in the total supply?

*Mr. Triffin:* Yes.

*The Chairman:* These loans would be made to individual central banks, not to individual enterprises?

*Mr. Triffin:* Not to individual enterprises, although again there I would not presume really to dictate in concrete detail how the negotiation might turn out in the end.

3. See above, pp. 81-82.

*The Chairman:* Is it a banker's bank?

*Mr. Triffin:* It is a banker's bank, although I would consider quite proper—but this is open to objection on the part of more conservative elements in the central banking world—for the Fund to invest in other first rate securities—those of the International Bank, for instance—any excess reserves which it may have on hand.

So you could really in that way help channel money into development and reduce to that extent the burden of development financing throughout the world.

*The Chairman:* Now, this opens up great possibilities. Assume that the United States has one-third of the reserves and the voting power in the new International Central Bank and that it loans in the order of what, a billion dollars a year?

*Mr. Triffin:* Yes; that is the rough average which I have estimated. If you assume that reserves, as a conservative estimate, should increase on the average—not every year, but on the average—by about 3 percent each year, well, 3 percent of \$60 billion is \$1.8 billion. You have about \$800 million of production of gold each year going into central banks. So the rest, \$1 billion, is the amount which might now come from Fund lending and investments.

*The Chairman:* Yes, but that is only a fraction of the amount which you can lend because you are using the fractional reserve system, not the 100 percent.

*Mr. Triffin:* The Fund should not necessarily use its full lending power.

*The Chairman:* I understand, but you could lend more than that.

Supposing you have a 50-percent reserve system which is three times our ratio, then you could lend \$2 billion a year.

*Mr. Triffin:* Yes; you could.

*The Chairman:* Then one-third of the American share would be \$667 million a year profit. This would help very much in financing the Government.

*Mr. Triffin:* There is one problem, of course. If you used this lending power to the full, you would then certainly run into the objection

that you are increasing world reserves at too fast a rate and that this is promoting inflation.

*The Chairman:* What you are saying is you are not afraid of inflation, you are afraid of deflation.

*Mr. Triffin:* That is right, but I am quite willing to recognize both dangers.

*The Chairman:* You are saying that the world monetary reserves and the world currency may not increase as rapidly as the potential increase in productivity?

*Mr. Triffin:* That is right.

*The Chairman:* And that productivity may be held back by an obsolete banking system.

*Mr. Triffin:* Absolutely.

*The Chairman:* And, therefore, you create an international system which would enable more monetary media to be created and the profits from this would be obtained not by the private bankers, but by the central banks?

*Mr. Triffin:* That is right.

*The Chairman:* And we would get a third of it, or \$667 million a year, in the situation we have discussed.

I commend this to the attention of Mr. George Humphrey and Mr. Robert B. Anderson.

(Subsequently the following letter was received from Professor Triffin clarifying the above discussion of loans and interest earnings made by the Fund:)

Yale University, Department of Economics,  
New Haven, Conn., November 2, 1959.

Senator Paul H. Douglas,  
Chairman, Joint Economic Committee,  
Congress of the United States,  
Washington, D.C.

Dear Senator Douglas: I wish to thank you very sincerely for the most enjoyable, stimulating and encouraging afternoon I spent with your Committee. I hope it will prove useful to you and to our country.

In re-reading the transcript, I notice that I failed to clarify a point which you clearly misinterpreted in your comments. . . . If the Fund lent \$2 billion a

year, such loans would *not* be allocated on the basis of each country's existing deposits, but would probably go largely to the countries with low, inadequate reserves. It is most unlikely that those loans would be made primarily to the largest deposit holders. The ownership of the deposits held with the Fund would merely determine the distribution of interest earnings made by the Fund on its loans. In your example, the United States would get one-third, not of the \$2 billion lent in any one year, but one-third of the interest paid by borrowers on this sum and on loans similarly made in previous years. You may possibly wish to modify your statement in this respect, and I apologize for not having drawn your attention to it immediately, as I forgot it while trying to discuss the broader issue of the Fund's total lending capacity.

On this point too, which very rightly interests you very much, I may possibly make a little simpler and clearer my verbal answer to you.

Whenever the new Fund would lend, this would merely create additional deposits. If these deposits could never be withdrawn in gold—as in the Keynes plan—but merely drawn upon to pay another country, the Fund's lending capacity would be *unlimited*. All that could happen would be a reshuffling among members of the larger and larger deposits created by the Fund, but the Fund could never go broke. In exactly the same way, a national central bank could lend unlimited amounts if it were not prevented to do so by specific legal cover or reserve requirements, designed to prevent inflationary abuses of such power. My proposals limit this inflationary danger, not by setting up reserve requirements—I do *not* propose any—but more directly and simply by placing a ceiling on the authorized annual lending of the Fund.

This allows me also to authorize deposit holders to limit to 20% of gross reserves the deposits which they are *compelled* to leave with the Fund. While this proportion would probably be ample in practice for a long time to come to give the Fund sufficient lending power, it might have to be increased in time, as production expands and demands a further expansion in international reserves and liquidity.

If this is not clear, I'll be glad to discuss it again with you, or you may wish to glance at pp. 27-29 of my June article.<sup>4</sup>

With many thanks again, and very best wishes,

Yours very sincerely,

ROBERT TRIFFIN.

*The Chairman:* Now, I regret that no members of the minority are here, but their very able members of the staff who serve as advisers to them and who are specialists in this field, Mr. Frucht, is here. I am going to ask that he take part in the questioning.

*Mr. Frucht:* Thank you, sir.

I want to say, first of all, that I have been for some time very much impressed with your diagnosis of this problem and your solution. I

<sup>4</sup> See above, pp. 103-104.

think that if this problem is to be solved, the solution is going to lie very much along the lines which you have indicated.

I have, however, a number of questions which relate in part to points that you made in reaching your solution that I do not think are necessarily tied to your general outlook but do fall into the pattern of steps toward resolving these problems which you worked out in your article for the Italian Bank Journal and are also mentioned here.

For instance, you suggest that it would be desirable to increase regionalism as a partial step in the direction of your final solution.

*Mr. Triffin:* Yes.

*Mr. Frucht:* I have a number of questions to ask you along this line. For instance, does this not court the danger that we might create international anarchy instead of international liberalization?

*Mr. Triffin:* I would like to pursue that discussion much longer, but this would take a lot of time if we went into all the technicalities of it.

The objection you mentioned is exactly the same as was made against OEEC, and especially against the creation of the European Payments Union, if you remember.

At the time, people who were supporting this move were meeting all the time with the objection that this would create a sheltered, high-cost, soft currency area protecting itself from competition by the rest of the world.

As you know, EPU has turned out completely opposite to that and you do not hear that objection today from anybody, even from Professor Kindleberger, or from the people in the Treasury who were so violently opposed to EPU on that ground. EPU had indeed the opposite effect, and Europe has become a much more competitive area in world trade, to the point where it begins to worry us.

I think there are very sound economic reasons why this could have been predicted. I tried to explain that at length in my book on "Europe and the Money Muddle." In fact, after all, if the liberal economists believe in the virtue of freer trade, one of the results of this kind of integration and lowering of barriers, even on a regional basis among those countries, must be to strengthen their economy and therefore to make them more able to do without those crutches

which were the restrictions against the dollar area and so on. And this is exactly what has happened. After having liberalized among themselves they have extended, gradually, liberalization to others. May I mention again a broad historical example in this connection. Some people say that this sort of integration on a regional basis would lead to more protection and to a slower rate of progress for the countries which enter into such an agreement.

I just put the broad historical question to you. Would Germany today occupy the kind of economic position it occupies in the world if it had never united into a Zollverein? Would the United States be in the position it is today if we had 48 separate tariff areas in our country?

To ask the question is to answer it. Yet all the weight of academic opinion has been on the other side ever since Viner wrote on this problem 20 years ago.

I think there is a perfectly valid and obvious answer to the technical points made by Professor Viner.

I shall be glad to take this up with you after the hearings.

*Mr. Frucht:* I think perhaps you would not deny that at the outset, say, in the Common Market with its still very heavy specific dollar discriminations plus global quantitative discrimination, plus bilateral dealings and soon with a common external tariff with lower tariffs within, that we do face, at least for a while, a rather formidable wall of discrimination?

*Mr. Triffin:* Yes.

*Mr. Frucht:* Not only the United States, but Japan and South America are particularly mentioned. Can you say that the position of Japan is not seriously harmed by such devices as this.

*Mr. Triffin:* I wonder if I can make two comments about this really which would help clarify this issue.

Let us suppose at the worst that the new European Community becomes a highly protective area. What would be the result, nearly necessarily? It would mean that their own gold and foreign exchange reserves would continue to increase at a terrific pace. I do not think that this could happen for very long without inducing those countries to remove some of the discriminations and restrictions which had been placed there at the beginning to protect them against balance of payment deficits.

On the other hand, I think that it also is true that because those countries were so sold on the dollar shortage by all economists in the postwar, they have been probably too conservative and too careful about their general policies, and really what I would expect now, over the next few years, is that wage rates and demand for consumption in those countries must adjust upward to the enormous increases in productivity and in the strength of their monetary position which have taken place since the war. I would expect that to happen nearly automatically. There is also no doubt that, although it could happen automatically, it could be defeated by the wrong policy. We should therefore continue to exert strong pressure on those countries to follow their own interest in this matter, and this would lead to a liberal external policy.

*Mr. Frucht:* This problem of discrimination of course has a particular bite in view of our balance of payments problem, in view of the position which you have so ably diagnosed. It takes on a peculiar importance. We are not in a position such as we were 5 years ago.

What could the United States do, do you feel, to see that dollar discrimination and other discriminations would be removed very fast? I must mention that these countries have solemnly covenanted to remove those the moment their balance of payments position is strong; yet they talk of removing them in 5 years.

*Mr. Triffin:* I think the movement will be much faster than that. Certainly, there are already quite a large number of important countries in Europe which have no discrimination today on imports from the dollar area except in the matter of agricultural commodities where there is no free market.

I believe that the French have already raised their rate of liberalization to 80 percent and I have been told that this would be raised further before the month is over. But I think we should probably continue to press them on that.

I understand that the present discussions in Tokyo are going pretty well. I think we should certainly have given much more support to GATT than we have been giving.

\* \* \* \*

*Mr. Frucht:* I wonder if you would express your opinion on the present fiscal policy of our Government in acting positively to stimulate the flow of American private investment abroad?

Do you feel that this is justifiable and desirable under the present circumstances?

*Mr. Triffin:* I would like to confess first that I have no real competence in this matter, and I do not know exactly what is the status of the present projects on this in Congress.

Let me simply make a comment which I would say should not be particularly forceful because it is not a matter with which I am familiar, but I believe there really is no reason—there is no longer any reason today—to try to stimulate capital exports by this country to the rich countries of Europe. Nor is it desirable to stimulate any further than it is already going now the exportation of American industry and employment opportunities to Europe. I think we should make a distinction there between the underdeveloped areas where some of those policies may still be relevant and the export of American capital toward the developed countries. I think there is no justification for the latter. There is no justification certainly for special fiscal favors in that respect.

*Mr. Frucht:* Going to the question that you ended up with, the possibility that it might take a crisis to shake us out of our complacency, I wonder if there is not also a danger that such a crisis might shake us into a position of very strong protectionism.

*Mr. Triffin:* Yes. That is what really frightens me because, if this were the way in which we react, in a sort of spirit of panic rather than cold judgment, I think that not only would this be unfortunate for the world as a whole, but I think also it would largely prove ineffective from our own point of view.

You remember that chart I showed you, for instance, about our capital exports to the underdeveloped countries. This shows very clearly that if we were simply trying to reduce those capital exports we would at the same time reduce our merchandise exports and it would not help at all our gold problem. So that we would really follow a will-o'-the-wisp there and think we are really fighting a problem when we are only running away from it and not solving anything. That, I think, is a very grave danger right now.

*The Chairman:* Of course, this is precisely what happened in the thirties, that countries became more and more nationalistic. England

abandoned its free trade policy and went to protection. Germany developed Nazism which had autarchy as one feature.

*Mr. Triffin:* I am very much afraid of that also. I am much more afraid of that than I am of a financial panic at this stage.

*Mr. Frucht:* I heard on the Continent a good deal of talk about the desirability of a very broad, a very strong surge on the part of all these countries picking themselves up by their bootstraps and going towards trade freedom in a hurry, liberalization in a great hurry. We have a terrific problem here in that present legislation only allows us to reduce our tariff 20 percent over the next 4 years.

*Mr. Triffin:* Yes.

*Mr. Frucht:* It would seem that we might fall into a serious trap in the problem both internally and externally if we were unable to move as fast toward liberalization as the rest of the world.

*The Chairman:* I do not want to scare off Mr. Frucht, but I will say, if you can make those fears known to your colleagues to my right, it will be very helpful because some of us fought, bled and died to even get the authority to bargain for tariff restrictions of 20 percent in 4 years and needed a major blood transfusion to really compensate for it.

*Mr. Triffin:* May I comment on that, something which I think may be particularly relevant and which I think will give you further information? I know that there are a number of extremely influential people in the European Economic Community who are very much aware of this fact you have mentioned, but who are also forward-looking enough to suggest this solution, temporarily at least: that the European Economic Community should go ahead, even unilaterally if necessary, because they realize how difficult it would be to get from the Congress the legislation necessary to authorize the reciprocal negotiation of large tariff cuts. Therefore, they would go ahead without waiting for us, and they would cut their tariffs unilaterally, and then expect us to follow suit as soon as we can. If, of course, this was not done after a reasonable amount of time and they ran again into difficulties on that account, they would then reserve the right to renege and to withdraw the unilateral concessions which they had made.

I think that is something we should encourage, but we should at the same time try to put ourselves in a position to follow suit and to consolidate this broad movement.

\* \* \* \*

*Representative Reuss:* In your paper, Mr. Triffin, you made the point that at least until we get some long-term solution to the problem of international liquidity there will be necessity here, I think you suggest, for a rather high interest rate policy in order to keep the holders of the \$17 billion foreign holdings from taking their money elsewhere to draw interest.

That is a rather appalling prospect to me: that we have to have a high interest rate, growth-defeating policy here because of the large amount of foreign investment. Therefore, I want to explore with you whether we really are caught up in this. Suppose we adopted an interest rate policy which, to my mind, would be more sensible in terms of domestic economic growth; namely, the policy of somewhat lower interest rates, and do our inflation fighting to a large extent by sounder fiscal policy?

*Mr. Triffin:* I agree, yes.

*Representative Reuss:* Suppose we did that, you still would have the problem, according to your thesis, of the overhang of the 17 billion foreign dollar holdings. Suppose we lowered our interest rates and some of our foreign creditors then lit out for Switzerland or Turkey to earn more interest on their money, taking their gold with them; would civilization collapse? Why could not Congress pass an unobtrusive little bill switching the present four to one gold ratio to whatever is necessary? Nobody would ever know the difference. Life would go on.

*Mr. Triffin:* Let me first make it perfectly clear that my remedy for this problem is not to keep our interest rate high. I am trying precisely to have a solution which involves a funding of a great deal of those funds so as to be able to recover the freedom to adjust our interest rates to our own domestic concerns.

*Representative Reuss:* I appreciate that your long term solution . . .

*Mr. Triffin:* It could be done as quickly as people can negotiate. In the meantime, I do not think—again I would insist on that—I do not

think that there is an immediate danger, an acute danger in that respect. As long as interest rates moved down also in Europe that would minimize the danger. But let me comment why we cannot simply get rid of this antiquated gold cover requirement. That was the other question you put and I would like to answer. I think we should have done so a long time ago undoubtedly, but I would be somewhat worried to use that weapon of lowering our legal gold requirements at the time when you feel there is danger really of a "run on the bank," because the introduction of such legislation at a time when we are precisely under pressure might trigger off more demands for conversion. You see, it might have very unfavorable psychological repercussions.

I think it is very unfortunate that we did not remove this kind of handicap, or albatross, at the time when nobody worried about the stability of the dollar. To introduce such a change at the time when foreigners are to some extent concerned, I think, might be introducing it at the most unpropitious time.

*Representative Reuss:* It is a factor, is it not, that we could lose a good deal of gold and still, under the present legal 4 for 1 ratio, have an adequate support for foreseeable currency needs?

*Mr. Triffin:* Yes, I think so. After all, what do we have there? \$19.5 billion roughly, and I imagine that our legal gold cover requirements now must be in the neighborhood of \$11 or \$12 billion. So that we have still ample room to meet any foreseeable conversion of foreign dollar holdings into gold.

*Representative Reuss:* Then, that I may be clear on the advice you are giving this committee, you do not really suggest, do you, that even now, for the short term, we should jack up the interest rates as a matter of national policy in order to attract foreign investment?

I would hope that you would not feel it necessary so to advise this committee, because it would seem to me an awful tail-wagging-the-dog proposition.

*Mr. Triffin:* As I say, I would like to escape from the dilemma essentially. As of right now, I believe that still the main purpose which dictated the policy which has been followed in that respect was the concern with our domestic inflationary developments. But, as I point out in my paper several times, I see this conflict arising and it may arise very soon.

I wish that we could really get out of the dilemma rather than have to sacrifice our external policy in order to preserve our internal policies, or vice versa. If we were forced to make a choice finally between the two, certainly I think probably the choice should go the other way. But I think we can escape from that.

*Representative Reuss:* I take it your suggestion for an escape is precisely the constructive suggestion you have made today that the International Monetary Fund constitutes itself a central bank.

*Mr. Triffin:* May I add to that possibly this: I realize, of course, that a reform of this character, although it is extremely simple in essence, might take some time and some debate. Therefore, it might take a long time before it could be implemented, possibly 1 year or 2 years, I do not know, but in the meantime, of course, you could achieve a great part of those purposes by a simple gentleman's agreement with the major reserve holders. An agreement between us, let us say, the British, and half a dozen European countries—the countries of the European Economic Community—would be sufficient to give us the time necessary for a complete revamping of the Fund.

*Representative Reuss:* In connection with your fundamental suggestion today, which for shorthand purposes we call the central bank feature of the International Monetary Fund, would there be any objection on your part if that suggestion were formally put by members of the Joint Economic Committee to the Secretary of the Treasury, the President, the Managing Director of the International Monetary Fund and people otherwise interested in the matter for their comment?

*Mr. Triffin:* I would say nothing would delight me more because I believe it would be the most constructive step and one of the most important ones that this committee might take to solve that dilemma about which you have been talking and which concerns me very deeply.

*Representative Reuss:* Thank you very much.

*The Chairman:* Doctor Eckstein, the director of our study, has some questions.

*Dr. Eckstein:* Dr. Triffin, one of our earlier witnesses, Mr. Despres, made suggestions which might accomplish some of the objectives that your proposal has and some of the more conservative. He suggested

## I N I T I A L R E A C T I O N S

in his paper one might devise some sort of guarantee scheme in which the major central banks guarantee each other's reserve. He mentioned both the United States, the Common Market, and the United Kingdom.

Do you see any merit in this proposal?

*Mr. Triffin:* It is also supported in some ways by Professor Haberler I understand.

First of all, this would raise some legislative problems but I think we could get around that in a different manner.

You could not necessarily give a gold guarantee to those countries but you might tell them informally that you promise that you would let them know in advance of any intention to modify the value of the dollar and you would achieve thereby the same purpose.

I do not, myself, support it at all by itself, for two reasons: One is that this would indicate a doubt on our part as to whether or not we will maintain the value of the dollar and this might increase the doubts of others.

Secondly, I do not think that any such guarantee would in the end reassure people sufficiently. If they feel that our position is deteriorating constantly, they would feel that we would be unable to honor that guarantee, no matter what we have said. After all, this has been evidenced many times in history.

On the other hand, again, I would consider possibly that in an informal manner it might very well be that a move of this sort might help us hold the line while negotiation for a permanent solution is proceeding.

As a transitory device and as part of a general negotiation, I think it would have a proper place, but by itself it is no solution, I assure you.

*Dr. Eckstein:* Another proposal which was presented here was some revival of the Tripartite Agreement.

*Mr. Triffin:* That is exactly in the line of the second suggestion I was making, you see. You give them 24 hours to convert any dollar balance they would acquire at the rate at which they had bought it. That is the essential meaning of the Tripartite Agreement.

*Dr. Eckstein:* Thank you.

*The Chairman:* We want to thank you for your very brilliant papers. I believe Congressman Reuss has a suggestion.

*Representative Reuss:* If it is in order, I would like to suggest that the committee refer this most constructive suggestion, which ought to be fully examined, to our executive branch, the President, the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve, and also to the Managing Director of the International Monetary Fund for such comments as they may have. Since we are short on members, I do not want to make it too broad. It may be that perhaps the three members present would feel like doing it.

*Representative Bolling:* I think we ought to include the groups to which we refer the appropriate committees of Congress since there is no Republican member present, I think, unless we get clearance from Republicans, we ought to do it individually.

*Representative Reuss:* I think if I may amend my suggestion, it could be very informal.

*The Chairman:* I would ask that a letter be drafted and if we get the clearance from the Republican members, it become an official letter from the committee.

If we do not get concurrence, it will be a letter from the individual members.

(Subsequently, concurrence being obtained the chairman transmitted the record of the day's proceedings and statement to the officials specified above.)

*Mr. Triffin:* Mr. Chairman, I would like to indicate something, of course, which worries me a little bit about this.

In making this presentation, I streamlined it and made it as simple as possible. I have been compelled, of course, not to enter into all the many objections which I know will be raised against this proposal.

*The Chairman:* This is not unfamiliar to any politician.

*Mr. Triffin:* To which I hope I will have some answers but which I did not try to develop today.

*The Chairman:* Doctor Eckstein will prepare such a letter of transmittal. I suppose that the articles, as such, and the cross-examination this afternoon should also be included.

*Mr. Triffin:* May I also suggest that this letter might draw attention

to the lengthy article in which I developed some of the technical aspects of the project.

*The Chairman:* If you have any more reprints to furnish us, we shall be glad to receive them.

*Mr. Triffin:* With pleasure.

*The Chairman:* This has been one of the most interesting afternoons I have had for a long time.  
I want to thank you very much.

*Mr. Triffin:* Thank you very much, Mr. Chairman and members of the committee.  
I have enjoyed it also.

#### *4. From the Administration*

#### *5. From the Action Committee for the United States of Europe*

The Action Committee for the United States of Europe was organized in 1955 in order to enlist broad public support for practical steps toward European unity. Presided over by Jean Monnet, it is composed of prominent political and trade union leaders from the six countries of the European Economic Community.

At its seventh session, on November 19 and 20, 1959, it adopted unanimously a joint declaration, the last section of which specifically endorses the proposals presented on pp. 138-141 above:

"The Action Committee for the United States of Europe would like to request the Council of Ministers of Finance of the six countries to include on the agenda of one of their next meetings, and to examine as a matter of urgency, the following questions of European financial policy, which in the Committee's opinion are of the greatest importance. In fact, the Rome Treaty makes necessary a financial policy common to the six countries. But the Treaty's provisions on this subject are of a very general nature. The Committee believes that they must be made specific and concrete in the framework of common economic policy by:

"1.—freeing capital movements between the six countries in such a way as to establish a veritable European capital market and thus to increase the Community's investment potential;

"2.—co-ordinating the budgetary and credit policies of the six countries in order to avoid the erratic movement of capital and of merchandise which would result from divergence of policy in this field and to further overall economic expansion against a background of price stability;

"3.—setting up a European Reserve Fund which would centralise at least a part of the six countries' monetary reserves and in time of need enable the mutual aid procedures provided for in the Treaty to be put into operation, thus safeguarding the currencies of our countries."

In its Issue of December 12, 1959 (pp. 1083-1084), the London *Economist* commented as follows on the Committee's declaration:

## AN IDEA FOR AID

In a Gaullist era, the direct influence of M. Jean Monnet and the band of friends who did so much to bring the European communities into existence is inevitably reduced. But as a source of ideas they remain important. The ideas that emerge from M. Monnet's action committee have a way of percolating outward to Brussels, and then perhaps back to Paris and on to Bonn, until they appear, one day—modified perhaps, and some time later, but none the less there—in the policies of governments.

Last month's meeting of M. Monnet's committee produced much that was familiar—a suggestion that trade problems should be tackled on a worldwide or an Atlantic basis, and a proposal for an Atlantic conference. But one section of the resolution that was passed went beyond the ordinary. It was a suggestion that the six common market countries should undertake a gradual pooling of their exchange reserves, both as a backing for their own evolving common economic policies, and to enhance their ability to aid the undeveloped world. In Brussels the European commission is already being advised by Professor Triffin, of Yale University, probably the man best qualified to devise and implement such a scheme.

There need be no doubt of the value of such a project if it were ever realised. To make a common economic policy really effective and expansionist, an economic union needs some such device. An article on page 702 of *The Economist* of November 21st suggested that any massive increase in European capital exports to the undeveloped world would require a major expansion of world liquidity. In the past the International Monetary Fund has lacked the political authority to carry out such big and long-term transfers of resources. Here at least is a part answer—a scheme for enhancing liquidity on a European basis within a system which has political teeth.

As an outsider Britain might well see such a project as a competitive threat to the status of sterling. Certainly, if Britain were in the scheme, sterling would stand to gain greatly from it. But the scheme has a chance of success just because it involves a greater pooling of sovereignty than Britain has yet been prepared to accept.

6. *From Premier Nikita S. Khrushchev, at the Chamber of Commerce in Paris, March 24, 1960:*

"Gold we have, but we save it. Why? I don't really know. Lenin said the day would come when gold would serve to coat the walls and floors of public toilets. When the Communist society is built, we must certainly accomplish Lenin's wish."