International liquidity—Problems and proposals

Although the Security Analyst is primarily concerned with the detailed study of individual companies it is clear that, from time to time, circumstances and events arise which are so fundamental and so far-reaching in likely effect that they must claim his prior attention. Many observers believe that the present problems of international liquidity are just such a circumstance and we consider the subject of such importance that, with the kind permission of The Society of Investment Analysis, London, we are reproducing an article prepared for the most recent edition of the London journal by Mr. Harold Rose, Reader in Business Finance, London School of Economics and Political Science.

Is there an urgent shortage of international liquidity which threatens to provoke a crisis similar to that of 1929? A fundamental problem which prevents a ready answer is that there is no single unambiguous or accepted measure of international liquidity, least of all one that can be tested to demonstrate the seriousness or otherwise of the present situation.

"Aggregate" World Liquidity?

One statistical measure which has been used by several economists to point to a decline in international liquidity is the ratio of world aggregate gold and foreign exchange reserves to world aggregate imports. Economists like Sir Roy Harrod and Robert Triffin have expressed anxiety at the decline in this ratio since 1945, which has brought the figure to a level below that prevailing in the years preceding the war. If we include in world reserves central bank holdings of gold and foreign currencies and their unconditional drawing rights on the International Monetary Fund (the so-called "gold tranche" positions of member countries) we find that for the non-Soviet world the ratio at the end of 1964 was about 43 per cent., compared with 89 per cent. at the end of 1948 and 107 per cent. in 1937-38.

Such a crude comparison, however, can be deceptive, and, indeed, more than somewhat irrelevant. It is deceptive if the measure is used to mark the contrast with the pre-war period, for then the value of world trade was abnormally low and the value of world reserves was abnormally high, taking into account the devaluation of the dollar in 1933. The latter increased the value of world gold reserves, which amounted to almost 90 per cent. of all reserves before the event, by three-quarters at a single step. If we go further back, to the last pre-war period of world boom, the critical year of 1929 itself, we find that the ratio was little different from what it is today.

It is true that there was a world financial crisis in 1929 and that for some years there had been rumblings of anxiety concerning the world payments situation. But a crisis can have causes other than an aggregate shortage of reserves, and the fact that there was a crisis is no test of the proposition that it was the world-wide deficiency of reserves that was the trouble, or that the crisis would have been avoided if there had simply been an all-round increase in their level.

A fact which is often overlooked is that in the years before 1914 the ratio of world reserves to world imports was only of the order of one-fifth, i.e., about one-half the present figure. Despite this the world was not brought to any situation of crisis because of any "aggregate" shortage of liquidity. One explanation, of course, is that the London capital market in general and the London discount market in particular operated so as to economise the need for reserves, by enabling surplus countries to pool their reserves and by providing a range of borrowing facilities for deficit countries. But that the development of the I.M.F., together with the present range of inter-central bank support arrangements, is potentially less effective a method of economising reserves is by no means self-evident.

The use of an aggregate ratio of world reserves to world imports may be irrelevant as well as deceptive because the function of reserves is to finance a balance of payments deficit, not the acquisition of imports on the assumption that export receipts are non-existent. A more useful statistical starting point, therefore, would be the ratio of world reserves to the total of annual balance of payments deficits. No such published series for a lengthy period exists, to my knowledge; but an examination of the balance of payments of the ten leading members of the I.M.F. (1) over the past fifteen years does not reveal any clear upward trend. (2) The net external balance of the group in recent years has been about one-fifth or less of annual imports; and their total reserves would represent five years' requirements, if the latter were interpreted to mean average annual deficits. This does not seem to be a particularly low level of

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(1) More precisely, the ten countries which entered into the Special Borrowing Arrangement with the Fund in 1962.

August, 1965 11

The Australian Security Analysts' Journal
liquidity for the group as a whole, especially as the full range of possible credit facilities has not been taken into account in the measurement of "reserves".

The basic deficiency of any such arguments, one way or the other, however, is that any aggregate world ratio really tells us very little about the potential degree of strain to which the international financial system may be subject. It is doubtful, to say the least, whether the degree of world liquidity can be represented by any such single figure at all. For the world as a whole cannot be in deficit, so that a single ratio of reserves to deficits cannot be constructed. The crux of the problem is that reserves are needed by individual countries to finance their deficits but accrue to countries in surplus. A world in which the method of adjustment led to deficits being removed fairly quickly and smoothly, i.e., without severe inflation or deflation, would need relatively less liquidity; but a world in which deficits persisted would probably be one in which the distribution of reserves, whatever their world total might be, would eventually be such as to give rise to strain. For it is the persistence of deficits that demeans countries of reserves, and it is these, not the persistent surplus countries to which reserves accrue, which are the countries that need additional resources.

A more rapid growth of world reserves, but accruing to surplus countries, would not be very helpful; it is not the shortage of their reserves that deters the countries of Continental Europe from taking effective steps to eliminate their own surpluses.

The fact is that the degree of world liquidity or illiquidity depends on the whole pattern of international financial relationships and cannot be represented by a single aggregate or average. The system can be judged more or less liquid only by reference to a framework relating the pattern of deficits to the pattern, not only of deficit-country reserves, but also to the degree of access to surplus-country reserves, a matter which involves questions of co-operation and of confidence.

**Strains in the International Payments System**

What cannot be denied is that the present system of international payments is now under great strain; but this is not the same thing as saying that the cause is an aggregate shortage of liquidity. For if we were simply to increase each country's reserves by a stroke of the pen, most of the problems would remain, e.g., if the developing countries, which possess few reserves, were to remain in deficit and if the Continental reluctance to hold dollars were to persist. Above all, it is the increasing dependence of the international payments system on the United States dollar as a "key" currency which has given rise to widespread concern.

As Table 1 shows, holdings of dollars have come to represent an increasing proportion of total world reserves, rising from 7 per cent. in 1949 to about one-fifth at the present time. Since 1949 the increase in central bank holdings of U.S. dollars has amounted to approximately one-half of their total increase in reserves. Sterling, which, it will be noticed, was quantitatively twice as important as the dollar as a reserve currency in 1949, is now very much the junior partner and has played no part in the growth of world reserves during the postwar period. Whatever the particular problems facing the status of the pound, it is now the dollar on which the operation of the world payments system depends.

This dependence on the United States dollar as the major source of the growth in reserves has had two main causes. The first is that the flow of gold into central bank reserves has dwindled despite an increase in Western world gold production and despite its supplementation by sales on the part of the U.S.S.R. Over the past decade the output of gold in the Western World has averaged about $1.2 thousand million per annum, and Russian sales have added nearly $500 million yearly. But the flow into central bank reserves has been little more than one-third of the total supply of about $1.7 thousand million per year. About $1 thousand million per annum has passed into private hands, of which less than one-half is thought to have represented the normal demand for industrial and artistic use.

Private gold hoarding, that is to say, has grown in magnitude, and this in turn has been due increasingly to the expectation of an eventual devaluation of the dollar, which would mean a rise in the world price of gold. The demand for gold on the London market, which has become particularly intense this year, itself threatens to draw gold out of the U.S.A. A rise in the price of gold in London sufficiently above that at which the U.S. authorities are prepared to sell gold may tempt unco-operative central banks to buy gold in New York for resale in London at a profit. To hold down the London price the international gold pool, with quotas contributed by eight countries, was instituted in 1961; but this can exert no more than temporary and not very effective delaying action.

The second, and fundamental, cause of the growth in the proportion of world reserves represented by holdings of dollars has been the emergence of a persistent U.S. balance of payments deficit. The United States has continued to have a surplus on its current account, but this has not been sufficient to finance the large grants and loans made by the U.S. Government and the outflow of long-term capital. As measured by the conventional U.S. balance of payments statistics the United States had a current surplus in 1964 of $6.4 thousand million but an "overall" deficit of $3 thousand million. The latter is the sum of official settlements (gold losses plus the increase in U.S. liabilities to official holders) to-

12 August, 1965
gether with the increase in U.S. liabilities to private holders. This exaggerates the true position; for an alternative representation is possible, allowing U.S. private short-term investment to appear as an offset to the increase in U.S. short-term liabilities to private holders. This would reduce the "overall" deficit to approximately $1½ thousand million in 1964.

Nevertheless, the increasing dependence of the growth of official reserves on the increase in dollar holdings is plain enough, and with the continuing deterioration in the net reserve position of the United States has come the loss of confidence in the dollar, which threatens to undermine the present payments system irrespective of the size of total world reserves. At the end of 1964 the total gold and foreign exchange reserves of the U.S.A. amounted to less than $17 thousand million, against which there were total short-term foreign liabilities of over $25 thousand million. Even if the short-term foreign assets of U.S. banks are added back, this still leaves a net liability of about $1,000 million, as against a net short-term asset position of more than $10 thousand million at the end of 1957.

The present reserve position of the U.S.A. is still much superior to that of the United Kingdom, which has sustained net short-term liabilities of about £2,500-£3,000 million for several years without a similar threat of the break-up of the sterling area system. Why should the United States not continue to build up a growing net liability position in the same way? There are three points at which the problems of the dollar and pound diverge. The first is that, for reasons of domestic economic policy, the U.S. Government, unlike the British, is reluctant to use interest rates to the full as a means of inducing the world to hold dollars rather than gold. The second is that, outside the American Continent, there is really no cohesive "dollar area",

that is to say, a system with reciprocal trading and financial interests as clear as those which continue, by and large, to sustain the sterling area throughout its own vicissitudes. For a decade after the war there was a kind of world dollar system, but one based on the assistance which the rest of the world sought from the United States. In this period, however, the U.S.A. was in balance of payments surplus, and the present dollar key currency system has really developed out of the emergence of the U.S. deficit (together with the commitment of the U.S.A. to convert dollars into gold). Thirdly, and this is a matter which is obviously related to the same historical developments, the recovery and advance of Continental Europe, especially the formation of the E.E.C., has confronted the United States with a contest for power within the Western world that has no close parallel within the sterling system.

**Criticisms of the Present System**

The present gold-exchange system, based increasingly on the dollar, has come under criticism on all sides, although certain forms of complaint levelled at the system are somewhat contradictory. The main lines of criticism are worth presenting, for proposals for reforming world monetary arrangements must be assessed in the light of which diagnosis is thought to be most appropriate.

(i) **The Political Contest**

To countries in the European Economic Community, and to France in particular, the persistence of the U.S. deficit, which could not continue if it had to be financed mainly in gold, represents a means of perpetuating American influence abroad, exercised through the flow of U.S. foreign investment and assistance. To these countries the indefinite provision of short-term credit to the United States amounts to an open-ended invitation to the U.S.A. to achieve power at their expense.

(ii) **A Bias Towards Inflation?**

The same countries—or their central bankers—tend to argue that the present system has a bias towards inflation. For the extended finance of a deficit caused by inflation leads the country concerned to export its inflation to the surplus countries.

The relevance of this to the U.S. deficit, however, is only partially valid. During the period of the American deficit, i.e., since 1957, the U.S.A. has had very little inflation, and in the years before 1958 what American inflation there was tended to be less intense and less persistent than that of many Western European countries, to say nothing of the developing territories. At present prices in France, Germany, Holland and Italy (and the U.K.) are rising more rapidly than those in the United States.

Nevertheless, the accusation does contain a more subtle truth, namely, that as long as the American deficit, whatever its cause, is not removed by American policy, the restoration of balance of payments equilibrium can be achieved only by changes in the economy of the surplus countries, changes which could include a relatively large rise in their money costs. If, because of the dollar-gold-exchange system, the American Government allowed the U.S. deficit to continue, the burden of adjustment would have to fall on the surplus countries. Such an observation, however, does not mean that no part of the responsibility for adjustment should fall on the surplus countries.

(Continued, Page 16)
finance a deficit by means of a continued increase in its liabilities, but other countries do not have this facility. An increase in their reserves, or in their credit facilities, so the argument runs, would remove unnecessary deflationary forces and make possible a greater degree of freedom in world trade and finance.

Whether or not one holds these views, it is obvious that, should the present system break down, which is another argument in this category, one consequence could be a development towards world-wide deflation.

If there were a prolonged run on the U.S. gold reserves the U.S. Government would be forced to react either by raising its own interest rates to very high levels; or by attempting to improve its own current account by a policy of internal deflation;\(^{(1)}\) or by curtailing even more severely the flow of assistance and loans to the rest of the world by administrative means. Whether or not the method of internal deflation were adopted, these policies would set up deflationary tendencies in the rest of the world, e.g., through the income effects of a deterioration of the current balance of payments of the countries concerned or because a reduction in the flow of dollar grants and loans would force many countries to restrict their domestic expenditure because of a shortage of foreign exchange. American measures to reduce the outflow of capital are already having effects of this sort. Moreover, the world-wide uncertainty that could result from a break-down of the present system could well have even more profound and far-reaching deflationary results.

\(^{(iv)}\) The Haphazard Nature of the Present System

Whatever one's view of the present degree of world liquidity, there is no doubt that the annual increase in world reserves is by and large a haphazard process, depending on a combination of accidents largely beyond our collective control. The annual supply of gold into official monetary reserves depends on the state of technique in gold mining and on the unpredictable and independent gold policy of the U.S.S.R., together with the, so far misinformed, acts of private gold hoarders. The increase in world foreign currency reserves, on the other hand, now depends largely on the persistence of the U.S. deficit, itself a source of concern to many surplus countries. The replacement of the American deficit by that of other countries would probably be even less readily financed by the accumulation of the deficit countries' short-term liabilities, so that world reserves would not be increased on any scale. Economists who emphasise these considerations stress the need for a planned growth in world reserves by means of some process or other.

\(^{(v)}\) The Irrelevance of Gold

Finally, there exists a widespread hostility on the part of the economists, if not of central bankers, to the use of gold at all as the basic international means of inter-central-bank settlement. This hostility is due not so much to the unreliability of the annual gold supply as to the belief that the use of gold is simply an unnecessary collective confidence trick derived from an ancient superstition. We no longer attribute powers of magic to gold itself, but we do to the collective willingness to price it beyond its industrial value. The production of gold uses up real resources, and the complacent, or fearful, acceptance of a gold-based system is seen as delaying the introduction of a more rational and less costly planned world payments system.

Before setting out the various proposals that have been made for improving the world payments system, it should be noted that some, at least, of its current strains could be reduced without the need to reform the system as a whole. For example, the United States could strengthen the attraction of the dollar by raising interest rates and by countering any deflationary consequences of such a step by pursuing a compensatory fiscal policy. But this would require a greater degree of understanding as to the role of a large Budget deficit on the part of opinion both in the United States and in Continental countries. Alternatively, a keener initiative could be taken by the countries of Continental Europe to eliminate their surpluses by means of a more liberal import policy or even by raising their exchange rates; but this would require the vested interests of exporters and of domestic industry to be overcome. A third line of improvement would be for the Continental countries to develop more fully their growing role as exporters of capital (and in the process, perhaps, to set up a third key-currency system). But this would require far-reaching institutional changes in the capital markets of these countries and, probably, a fall in their interest rates to levels that would make it more attractive to borrow in these countries. This, in turn, would mean that these countries, like the United States, would have to be willing to resort increasingly to fiscal rather than to monetary policy as a means of stabilising internal demand and prices.

The point of presenting these possibilities is not to deny that the world payments system may be in need of fundamental reform, but simply to observe that both diagnosis and prescription really depend, in part, on what we assume to be unalterable in the policies of individual countries. The pursuit of more enlightened policies would make it less necessary to seek an urgent solution of the truly formidable problem of devising a new and widely acceptable world currency arrangement.

It should also be observed that any method of balance of payments adjustment that accelerated the elim-

\(^{(1)}\) Or by devaluation vis-a-vis other currencies.
nation of deficits would reduce the need for reserves. For example, a system of freely fluctuating exchange rates could almost eliminate the need for reserves entirely, insofar as balance of payments equilibrium was achieved instantaneously by movements in rates of exchange. There are many conditions that would have to be met for such a system to function without causing even greater instability than at present, of which perhaps the most important is that private speculators would always have to act with sufficient foresight as to hold exchange rates close to their long-term equilibrium levels. For example, speculators would have to support an exchange rate of a country thought to be only in temporary balance of payments deficit, thus, in effect, furnishing that country with the liquidity which, under the present system, it is the function of exchange reserves to provide.

There are many other considerations which make it most unlikely that a system even of very flexible, if not completely free, exchange rates would be either desirable or acceptable. But there exists an entirely respectable school of thought which maintains that it is not so much the question of reserves as of balance of payments adjustment that is really the crucial problem in a full employment world, in which downward cost movements are improbable as a method of securing long-term balance of payments disequilibrium. To economists of this opinion, some additional degree of exchange rate flexibility seems necessary, either in the form of a widening of the existing parity limits or of the right of a country to change its exchange rate more or less continuously, but by a very small proportion each year.

Such matters are of too great a degree of complexity to be treated here, and even a moderate extension of exchange rate flexibility would still require close international co-operation, as the experience of the pre-war decade shows. There is no sign of any widespread agreement in official circles that any solution is to be sought along these lines; although periodic exchange rate adjustments, of course, are inevitable.

**Proposals for World Monetary Reform**

There is no shortage of proposals for improving the world payments system: about twenty different schemes have been suggested over the past few years. Only a broad survey of their basic characteristics will be presented here; those interested in a more detailed review will find an expert assessment in “Plans for the Reform of the International Monetary System”, by Fritz Machlup.

The proposals so far made fall into three classes: those for extending the range of mutual assistance by central banks; those which envisage the development of a centralised reserve system with some international monetary authority; and those which recommend the establishment of a composite reserve system expressly based on gold.

**Extended Mutual Assistance**

Schemes in this group recommend what amounts to the development of a permanent pre-arranged and multilateral currency “swap” system, in which all the important central banks would participate. Such an extension of the “swap” agreements developed by the U.S.A. since 1962 would have the main object of neutralising movements of private short-term capital which threaten to undermine the present system. An outflow of funds from the U.S.A. to Germany, for example, could lead in the first instance to the Deutschebank holding dollars beyond its normal requirements. Activation of the “swap” would provide the U.S.A. with D-marks with which it could support the dollar in the open market or purchase outright the excess dollar holdings of the German authorities, leaving the U.S.A. in debt to Germany.

In general the credits created directly under the arrangements would only be temporary and would not lead to a permanent increase in world reserves unless the key currency countries were in deficit and used their drawings to make payments to third countries, which would then end up with permanent holdings of a key currency.

On the other hand, if the U.S.A., for example, continued to run a

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(Continued on Page 18)
deficit all the present disadvantages of the present system would remain. To broaden the system, therefore, some schemes envisage the development of additional key currencies, especially those of continental Europe. But whether this would be a net advantage is doubtful, for the experience of the period of bimetallism and of the twin key currency system of the twentieth century indicates that the degree of instability of the world payments structure increases with the number of key currencies and financial centres. The necessity for the key currency countries to keep their balance of payments more or less in harmony—in order to avoid a speculative outflow—could cause the system to have a deflationary bias if stability of exchange rates was to be maintained.

It may be observed that the operations of the International Monetary Fund resemble those of a multilateral system of "swap" agreements, with the I.M.F. acting as an intermediary. For member countries in effect lend their own currency to the Fund in return for the right to borrow the currencies of other countries, the "swap" being carried out via the Fund and not directly with the countries concerned. The operations of the I.M.F. could be extended much further in this direction, e.g., by annual increases in quotas and by raising the proportion of drawing rights which are unconditional.\(^1\) The latter facility would require the Fund to be assured of an ample supply of potentially "scarce" currencies by means of an extension of the so-called General Arrangement to Borrow.

The recent decision to increase I.M.F. quotas by 25 per cent and the development of more liberal lending arrangements by the Fund, e.g., through the provision of standby credits, can be regarded as a substitute for the establishment of a more complex and more cumbersome system of direct "swap" agreements. But even the extension of I.M.F. activities, within their present framework, would lead only to a very small permanent increase in reserves, and this only by accident, depending on the drawing position of key currency countries and the use to which drawings were put.

The willingness of "creditor" central banks to participate in the system would be strengthened by the provision of gold guarantees on all "swap" credits. At present the U.S.A. firmly refuses to give a gold or foreign exchange guarantee on its official liabilities as a whole; although it does so under special arrangements such as "swaps" and the sale of so-called "Roosa" bonds to central banks. The provision of such a guarantee under an extended "swap" system, however, would in effect be limited only to those marginal quantities of currency which take central bank holdings beyond the amount which they are prepared to hold willingly.

Such a system would undoubtedly give a greater degree of protection against the disruptive effects of private capital movements and could, if necessary, also be extended to financing deficits on current account; although this is not intended to be the object of most schemes in this group. The shortcomings of such arrangements depend on one's diagnosis of the malaise of the present system. To those economists who are most concerned with augmenting world reserves, even a widespread and liberal network of "swap" agreements would seem to be only a relatively trivial extension of the present gold-based system.

A Centralized Reserve System

The I.M.F. does not act as an international central bank but simply as an intermediary between member countries, borrowing and lending national currencies. The characteristic of a central bank—or of any "true" bank, for that matter—is that its own liabilities are acceptable as a medium of exchange. If there were an international central bank, then national central banks would settle their balance of payments deficits by drawing down their balances in the books of the international body, and surplus countries would correspondingly receive payments in the form of an increase in their book balances with the bank. Moreover, from the acceptability of the bank's liabilities as a means of settlement would follow the power of such a body to increase its liabilities—and, therefore, the total of world monetary reserves—by deliberately raising its assets. It would do this by making loans to member countries or by purchasing national government securities. As world exchange reserves would, to some extent or other, be held in the form of claims on the international body, the increase in world reserves would be a subject of deliberate policy on the part of the bank and not largely a matter of accident as at present. Moreover, the bank could lend to deficit countries and so protect them against disruptive capital movements or allow them more time to carry out structural changes smoothly and without the need for undesirable emergency measures.

In one form or another, these are the features of the several proposals to set up a centralized reserve system with the characteristics of an international bank. The proposals vary in several ways, e.g., with respect to the extent to which existing reserves might be handed over to such a body; or with respect to the powers of the bank to initiate an increase in its own liabilities; and on the question of political control.

The earliest post-war proposal was that put forward by Lord Keynes, who recommended the establishment of an International Clearing Union with liabilities denominated in "Bancor", which would be the means of settlement between member banks. The object of the scheme was not to increase

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\(^1\) This is the essence of the Bernstein plan, for example.
world reserves in any deliberate fashion, however, but to finance deficit countries by means of I.C.U. overdraft facilities. It was the problem of international deficit financing, rather than that of "world" liquidity, which appeared most pressing at the time. Keynes proposed to induce surplus countries to participate in smoothing out international disequilibrium by charging interest on both debit and credit positions with the I.C.U.

The International Monetary Fund, largely because of American opposition, became the post-war substitute for the Keynesian Clearing Union proposal as a result of the Bretton Woods discussions. More recent would-be reformers of the system which has been the product of Bretton Woods seek to go further than the Keynesian plan by giving an international body, such as a revised I.M.F., deliberate powers to increase its own liabilities year by year, with the intention of raising world reserves in accordance with some assessment of the needs of "world" liquidity.

The principal set of proposals in this category are those associated with the American economist Robert Triffin, who has gone farthest along the road of proposing the establishment of a full-blooded international bank, which would begin life by absorbing part of the exchange reserves now held by member countries and whose book liabilities would increasingly become the prime means of international settlement. Although a gold guarantee could be built into the system in order to induce central banks to participate, the fundamentalists of this school envisage the eventual elimination of the use of gold as means of exchange. Arrangements would have to be made to replace the liabilities of key currency countries to other countries by liabilities to the central organisation.

Some policy would have to be agreed on as to the annual increase in reserves at which such an international body, which could easily be developed from the I.M.F., would aim; and this would have to be revised in the light of experience. Deficit countries could be financed within limits also subject to broad agreement as to principle, and the effect of disruptive capital flows could easily be neutralised. The pooling of reserves and the provision of access to deficit financing would economise the need for reserves as a whole.

Such a system has immense appeal as a radical solution to the problems of the international payments system. The basic obstacles to its implementation, which look like being insurmountable for many years, are, first, that member countries would have to accord the bank's liabilities the same degree of confidence they now accord the use of gold. As the breakdown of any such system would probably reinstate the use of gold, a lack of confidence in the system would have effects similar to those emanating from the distrust of the dollar as a reserve currency. The advance along the Triffin road, therefore, would have to be gradual. Secondly, there remains the fear of France and other countries that any credit-based system would be too generous to deficit countries, leading to unnecessary inflation and, as in the case of the U.S.A., to an unjustifiable reinforcement of the concentration of political power. The reply of Triffin to this is that the provision of deficit finance could be as restrictive as members as a whole thought desirable; indeed, it could probably be more limited than is the case at present, when most central banks are prepared to be generous in their support of sterling and the dollar in order to avoid disrupting the system as a whole.

The third disadvantage usually attributed to such proposals is that it would concentrate power excessively in the hands of the central body. How far this would be true, however, would depend on its constitution; and Triffin and others like him emphasise that the operations of the bank could be subject to as high a degree of international consultation as those of the I.M.F. and the various ad hoc arrangements are today.

One variant of this scheme worth noting is the Stamp plan, under which the liabilities of the central body would be in the form of certificates. These, initially, would be distributed to the developing countries and would have to be accepted by surplus countries as a form of reserve, according to agreed quotas. The difficulty of such an arrangement, however, is that the main assets of the central body would be in the form of claims on persistent deficit countries, and the prospect of repayment would be small. Whether the surplus countries would be prepared to any great extent to hold certificates backed by so little security is doubtful.

Gold and a Composite Reserve System

The extreme opponents of a credit-based payments system, like Monsieur Rueff, advocate the return to a simple gold standard, accompanied by a rise in the price of gold. However, few economists or, indeed, central bankers share his interpretation of the operation of the nineteenth century gold standard as an automatic, self-sustaining system, combining smooth adjustment in international payments with stabilisation of internal demand. The adequacy of the growth in world reserves in the period from the Napoleonic wars to the 1929 crash was largely a matter of accident, based on the increase in silver supplies in the first half of the nineteenth century and the discovery of new goldfields and mining techniques in the second, together with the withdrawal of gold coin from circulation in the twentieth century. At the same time the importance of international credit was growing steadily. Central banks did not automatically follow the "rules" of the gold standard game; but the system
as a whole had the benefit of being basically a centralised single-centre structure. This is no longer true; and, moreover, few economists would recognise the degree of potency attributed to monetary policy as an internal stabiliser by Monsieur Rueff.

Nevertheless, there is wider support, especially in France, for an augmented but explicitly gold-based system. The basic proposal is that countries should agree to hold a range of currencies and gold as their reserves, in fixed proportions and subject to a gold guarantee. The most practicable of such proposals envisage these composite units being held as homogeneous claims on the I.M.F., which would act as an intermediary and hold the actual bag of mixed reserves, thus obviating the need for complex consultation between a large number of central banks. Some schemes propose a gradual fall in the proportion of gold to be held, but the basic object of the more gold-orientated type of proposal is to restrict the growth of credit reserves, while at the same time increasing the number of reserve currencies. Although this group of proposals is less restrictive than the call for a return to a full gold standard which previously appeared to find favour in official French circles, it does possess many of the rigidities attributable to the full gold standard, and in a world in which the development of a number of financial centres and the effect of full employment policies in preventing cost-decreases would provide an unfavourable environment for such a system.

Apart from this, the call for a rise in the price of gold, which in such schemes is to provide an initial increase in world liquidity, is regarded by many economists as something to be rejected unless other means of liquidity expansion are not internationally acceptable. For such a measure would give mainly to those that already hath, and, moreover, would reward those countries whose conversion of dollar assets threatens to cause the very crisis in the present payment system of which a rise in the gold price would be a consequence. The enrichment of South Africa and the U.S.S.R., too, would not meet with widespread approval. Above all, a rise in the price of gold, which would probably have to be one of at least 100 per cent to prevent further speculation in gold, would delay for decades the advance towards a more rational credit-based system.

Some Conclusions

Although it is difficult, for reasons outlined above, to substantiate the complaint of a world aggregate shortage of liquidity as a potential source of world crisis, there is in certain respects an uncomfortable resemblance between the strains of the present situation and those of the late nineteen twenties. Then the U.K., like the U.S.A. today had a long-term capital account deficit in excess of its current surplus, and its short-term liabilities were a source of weakness. In an attempt to bolster the pound, the Bank of England sought the assistance of other countries, notably the U.S.A., and raised interest rates in Britain. The desire of the United States to hold interest rates at a high level in order to check the American boom, however, was just as important an embarrassment to the pound then as high interest rates in Western Europe are to the dollar today. Furthermore, France was just as intent raised interest rates in Britain. The consequence will be the radiation of deflationary forces on a wider front. Perhaps the greatest threat to the system emanates not directly from the dollar but from the danger that American measures may press already weak currencies, like the pound, closer to the brink of crisis.

For these strains to be avoided the balance of payments of both the U.S.A. and the U.K. would have to improve, and, moreover, without harming other weak economies, such as the developing countries. Such a conjunction of events would be fortunate indeed. The absence of world agreement on the need for radical reform of the present payments system could have the unfortunate effect that any further shock, such as that caused by changes in exchange rates, would find the world unprepared for its consequences.