Jacobsson, Per (1894-1963)


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INTERNATIONAL MONETARY PROBLEMS
1957–1963

Selected Speeches of
PER JACOBSSON

International Monetary Fund
Washington, D.C.
1964
INTERNATIONAL MONETARY PROBLEMS, 1957-1963

The speeches in this volume were given by Mr. Jacobsson during his tenure of office as Managing Director of the International Monetary Fund, from December 1956 until his death in May 1963. They include the reports which he presented at the spring meetings of the Economic and Social Council of the United Nations and the addresses in which he introduced the Report of the Executive Directors of the Fund at the Annual Meetings of the Board of Governors in September or October of each year. Ten other addresses and a background paper, representative of his thoughts on different phases of recent economic history and on a variety of current topics, have been chosen.

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The speeches here reproduced include the reports presented at the spring meetings of the Economic and Social Council of the United Nations (omitting only the first, which has been published in Some Monetary Problems—International and National). They also include the addresses in which he introduced the Report of the Executive Directors of the Fund at the Annual Meeting of the Board of Governors in September or October of each year. Ten other addresses and a background paper, representative of his thoughts on different phases of recent economic history and on a variety of current topics, have been chosen to give some idea of the range of his reflections.

The circumstance that Mr. Jacobsson delivered a series of major addresses at approximately half-yearly intervals enables the reader to re-create the changing economic environment of the years 1957-63 as it appeared from month to month to an exceptionally acute observer with unusual facilities for seeing behind the scenes. The Executive Directors of the Fund believe that, if for this reason alone, the collection will be of interest and value.

There is little need to amplify the descriptions given in the speeches themselves of world conditions at the time each was delivered. The reader may, however, find it convenient to refer to the table and charts on pages 356-60 which give the dates of the

1 Oxford University Press, 1958.
chief events and a summary of the changes in trade, prices, and reserves which influenced the world economy during the relevant years.

The speeches are printed as delivered, except for the omissions (which are indicated) of a few paragraphs that are repetitive or no longer of interest. Some repetitions have, however, been left untouched—notably where concepts sketched lightly in one speech are elaborated in a subsequent one. A number of recitals of the Fund's transactions and other activities have also been omitted, except where such details are used as illustrations for more general comments. Crossheadings have in all cases been added.

The selection and editing of the speeches have been done within the Fund, principally by Mr. J. Keith Horsefield, with the collaboration, which I gratefully acknowledge, of Mr. Jacobsson's daughter, Dr. Erin Jucker-Fleetwood, of the Basle Centre for Economic and Financial Research.

Washington, D.C.
December 1963

P.-P. SCHWEITZER
ABBREVIATIONS

References in this volume to publications by the International Monetary Fund have been abbreviated as follows:


*Articles* Articles of Agreement

*Enlargement of Fund Resources* Enlargement of Fund Resources Through Increases in Quotas: A Report by the Executive Directors to the Board of Governors, December 1958

*Selected Decisions* Selected Decisions of the Executive Directors, Second Issue, September 1963

*Staff Papers* [International Monetary Fund] Staff Papers

Europe’s Postwar Monetary Experience*

Let me begin with some general comments about the lessons and experiences of the past. When World War I started there had been no great war for a hundred years—not since the Napoleonic Wars—and the problems then were so different that past experience had little significance for the problems which arose in and after 1914. It was therefore largely through trial and error—many trials and many errors—that the countries affected gradually, but rather late in the war, learned how to run a wartime economy—with rationing, controls, special financial measures, etc.

Then in the interwar period (from 1919 to 1939) these experiences were carefully studied—and closely compared with Dr. Schacht’s re-employment policy in Germany under Hitler, a policy which had in many respects the characteristics of a policy applicable to a wartime economy.

Thus when World War II broke out in 1939, most governments had at their disposal detailed plans already prepared of how to deal with the economic and financial problems which were likely to arise in a great war. There can be little doubt but that through timely rationing, price controls, etc., much economic suffering was avoided of the kind that had plagued people during World War I. There were worse horrors than in World War I in other fields, but in the field of economic and financial activities matters never got completely out of hand as they had done in so many countries during World War I.

It is not my task here today to discuss these various war problems. I shall only refer briefly to one of the wartime developments which was of particular importance for the subsequent state of affairs.

* Delivered at the Centro de Estudios Monetarios Latinoamericanos, Mexico City, July 15, 1957.
Effects of World War II

No great war can be carried out without inflationary financing, and thus during both World Wars I and II the conditions for strong monetary demand were established. But during World War II, in contrast to the earlier war, government controls were generally successful in preventing shortages from raising the price level; thus at the end of World War II there was, on the one hand, a high degree of financial liquidity because of all the new money that had been issued, and, on the other hand, relatively low prices, at least as compared with the corresponding period of World War I and as compared with the money volume. This relationship was noted in the Annual Report of the Bank for International Settlements which was published in December 1944, and the conclusion was drawn that there was likely to be an excess of money in relation to the goods available at the current price level, and that there would therefore be a tendency for prices to rise rather than to fall. One would therefore not have to fear, as after World War I, any pronounced fall in prices when the war was over. In fact it was said in that report that it was not likely that there would be any postwar depression. It was perhaps easier to see this in the center of Europe, where the differences as compared with the conflict 25 years earlier stood out quite clearly. But the curious thing is that in the Anglo-Saxon—and I might add also in the Scandinavian—countries the consequence of the difference in methods of handling the economic and financial problems during the two wars does not seem to have been grasped. It seems to have been assumed, much too readily, that the well-known experiences after World War I would be repeated, and that there would therefore be a tendency to deflation and depression within a few years after the war was over. Here one finds a case of experience being, so to say, a dangerous thing. You know the old saying that generals are apt to prepare to fight the last war instead of adjusting their methods to the new techniques which are being developed.

Thus, the authorities in most countries were anxious to guard against the emergency of a depression when the danger was in fact the opposite—a strong tendency to inflation. It is quite clear that this mistaken view of the situation and its potentialities has had a great influence on the policies actually pursued, on the continuance of cheap money, and generally created resistance for years to any
kind of restrictive fiscal and monetary policies. I might add that even the Articles of Agreement of the International Monetary Fund show clearly the influence of those who feared deflation rather than inflation.

But let us now try to make clear what exactly the situation was at the end of the war. There was in most countries too much liquidity, that is to say, too large a money volume. It was as if a man had too large a coat. There are then at least four things that he may do:

(1) He may leave the coat as it is, expecting to grow into it so that it will fit him one day; or
(2) He may cut it down so that it fits him straight away; or
(3) He may take in the coat temporarily; or
(4) He may conceivably be so wrong-headed that he adds further to the coat, not realizing that in such a case it gets even more unsuitable.

I am afraid that a few countries actually allowed the central bank to increase liquidity even after the war was over. Those who had been belligerent and had many difficult tasks to fulfill may perhaps be forgiven for doing so, but when a country such as my own—Sweden, neutral in the war—embarked upon such a course of action, I find it difficult to invent any excuse at all. There cannot be many Swedes today who would defend the credit policy of the year 1946-47—of pegging the long-term rates by extensive central bank purchases of government bonds, a policy which led to the loss of two thirds of the monetary reserves. That was a time for restriction of credit and not the issue of new credit.

Currency Reforms and Korea

It is fortunately possible to prove that at that time a policy of even vigorous credit restriction was the appropriate one: for one has an example of Western Germany, where the coat was drastically cut down. In June 1948 no less than 92 per cent of the existing money volume was extinguished. Overnight Germany got a good currency, and within a few months the economic life of that country was changed from one of sullen inactivity to a spurt of vigorous private enterprise in practically all fields. What then happened, after the three barren years from 1945 to 1948, will
The German currency reform was carried out in 1948, but I ought to mention also what had happened in Italy in the previous year when Professor Einaudi, first in the capacity of Governor of the Banca d'Italia and then as both Governor and Budget Minister, succeeded in applying a stiff policy of fiscal and credit restraint, including a reduction in budget expenditure (including among other things the abolition of the bread subsidy) and great restraint on the availability of credit. There was at first great opposition to this policy, but it soon became evident that the lira had been made a good and stable currency, and a grateful country elected Einaudi within a year and a half to the high office of President of the Republic.

Now I do not want to say that all countries should have cut down their money volume as in Germany; in some the monetary coat was not too large—as in Switzerland—and in Belgium it was sufficient to take it in a bit, especially as that operation was followed by a sound flexible credit policy. But I want to underline that those countries which carried out in those years a careful credit and budget policy have had no reason to regret it. There was no danger of deflation in the world after World War II.

The summer of 1950 saw the outbreak of the Korean crisis. It was feared that essential materials would soon be in short supply, and a buying spree set in, especially on the continent of Europe. Imports rose rapidly, deficits emerged in the balances of payments, and monetary reserves began to run out. What steps should be taken? In a number of continental countries, especially in Belgium and the Federal Republic of Germany, a policy of financial
restraint was introduced with a limitation on the supply of credit through increased interest rates and other measures, and this policy was soon found to be successful.

It was only in the following year, i.e., in March 1951, that the Federal Reserve System in the United States ceased to support the market quotations of government securities, and in November of the same year that the Bank of England increased its discount rate. Some of the Scandinavian countries were even more behindhand in this respect. Why was it that the continent of Europe was thus so clearly in advance of the Anglo-Saxon and the Scandinavian countries?

Consequences of Inflation

One reason is quite obvious. People on the continent of Europe had seen at close quarters the evils of an unbounded inflation, and their own experience was in this respect of greater importance to them than any amount of economists’ forecasts with threats of a postwar depression. In Italy it had been quite clear that inflation had become an unmitigated evil. Credit expansion in that country could not even reduce unemployment. It is true that under certain conditions it may be possible to mobilize resources for investment by a kind of credit expansion, but then one essential condition is that the public still retains to a certain extent confidence in the currency. For then the new money issued will only slowly be dispersed in the economy; with the new distribution of income, characterized by increased profits, certain additional savings may be forthcoming to supplement the already existing flow of voluntary savings. But these are what have come to be called “forced savings.” These arise in several ways: (1) bank notes lose in value and there is thus a reduction in real money holdings; (2) a different pattern of income distribution is affected by (a) wages lagging behind prices, (b) taxes paid in shrinking money values rising, and (c) debtors gaining at the expense of creditors. A voluntary element is introduced since the firms who gain more in increased profits may not distribute all the new gains as increased dividends. But ultimately these savings are “forced” since they are all the result of involuntary curtailment of consumption. If, however, the public begins to fear for the value of the money, it is likely that everybody will try to buy as soon as possible, and in that way
not only will the "forced" savings due to credit expansion no longer be forthcoming, but the ordinary voluntary savings will be heavily reduced, or maybe almost disappear. Then there is no choice but to adopt a policy of putting an end to inflation by a return to monetary stability. In countries in which the public has at least once suffered a monetary disaster it is not likely to tolerate a continuance of inflation or of further devaluations. And it also seems that in those countries in which inflation has not been very destructive, as in Great Britain and the Scandinavian countries, the public is beginning to be tired of even a moderate inflation. Credit creation can be no permanent substitute for savings; that is the conclusion to which the European countries have come.

It is perhaps invidious to mention particular examples, but I might refer to the experience of Finland. Several times, both after World War I and more recently, that country has preferred a moderate devaluation to a stiffer credit policy. The result has often seemed very satisfactory, at first; declines in business activity have been avoided and export sales have been brisk. So it has happened that in Finland the bulk of the business people, the labor unions, and the general public have come to expect that instead of facing up to any difficulties, another devaluation could be looked upon as "the way out" when troubles arose. But if repeated devaluations occur, savings in money form disappear—there will be no capital market, as is the case now in Finland. The present Governor of the Bank of Finland has come to the conclusion that only a shock can teach the Finnish people that the authorities have at last decided to safeguard the integrity of the national currency. In France, as in Finland, there is a growing resistance to devaluation as an easy "way out."

Benefits of Credit Limitation

Let me look at the same problem in the light of another experience. When in the autumn of 1950 I was, together with Alexander Cairncross, one of the two independent experts appointed both by the OEEC and the German Government to look into the German balance of payments problem, the solution recommended and actually put into force was one of tighter credit and stiffer fiscal policies. When the expansion of bank credit was curbed, there were many in Germany who said to me that this step would reduce
the volume of investment and the level of business activity. Perhaps for a short while, I said, but not for long. My reasoning was the following: credit expansion can never be a substitute for savings; before long it will be the flow of genuine savings that determines the volume of investment; now, the stiffer fiscal and credit policies which serve to safeguard the value of money and thus maintain the confidence in the national currency will lead to higher voluntary savings and therefore to more investments. That is what did in fact happen in the Federal Republic. The tremendous amount of investment would not have been realized had it not been for the confidence in the currency. The last Annual Report of the BIS, published in June this year, confirms this view when it says that "restrictive monetary policies appear to have exerted their usual retarding effect on the growth of demand when first introduced (as is shown by what happened in Italy in 1947, in Germany in 1948, and in France in 1952) but to have promoted economic development in the long run." In fact, other countries which have pursued cheap money policies over long periods have not done so well as Germany, Italy, and France. France however has overdone it, and the level of investment has once again outrun the flow of genuine savings; the two other countries are on a more stable basis. But it is well to remember that France is very dynamic—the birth rate is the highest since 1846 and higher than in Italy!

More recent experiences in Europe point to the fact that credit expansion is no longer productive of either forced or increased voluntary savings but leads to a deficit in the balance of payments and thus eats up part of the monetary reserves—one kind of investment being substituted for another; increased domestic investment is offset by disinvestment in reserves. Recent developments in India point in the same direction.

This is, of course, a matter of the greatest importance. European and some other experiences lead to the conclusion that a policy of generous credit expansion followed by devaluations at various intervals will not be conducive to the sustained development of a country's economy. Circumstances do, of course, occur when a devaluation becomes necessary, but barring these exceptions, most important in 1949, Europe has opted for stable exchange rates. Europeans believe that a fluctuating rate—a floating currency—will be a falling currency, and that they want to avoid.
From 1948 to 1952 Europe benefited from the receipt of Marshall aid, which has been of great importance; but in itself this aid could not have brought about a state of equilibrium. A series of internal and other measures were also needed. There were first the devaluations of 1949, not all necessary, but on the whole useful to diminish the excess liquidity in the various economies; and secondly, the stricter credit and fiscal measures taken in various countries. As I have already mentioned, it was very largely the Korean crisis that forced the adoption of these saner policies.

The result was that at the end of 1952 European countries were in a condition of fairly general equilibrium. Then came the 1953-54 recession in the United States. Until then, people had believed that Europe was much dependent on business conditions in the United States, as in the 1930's, after 1929, and again in 1949. It had even been said that when the United States sneezes Europe gets pneumonia. Now it happened that, notwithstanding the recession in the United States, European business was not only fully maintained but became more active. This helped to strengthen Europe's confidence in itself. Even too much confidence, since it nurtured a belief in an early return to convertibility, a goal which must be reached by a step-by-step advance. But it was soon found that such moves were premature.

*The New Boom*

It was when conditions changed in the United States, and a new upturn began in 1955—one that has continued ever since and developed into a world-wide boom—that the new strains and stresses became apparent. This is now the new situation that not only Europe but the whole world has run into.

What are the causes of this boom?

There is every reason to believe that it is part of an ordinary upward trend of the business cycle, superimposed on a long-term ascending trend of economic activity. Why there is this long-term upward trend is perhaps not easy to tell. Previous trends of this sort, as from 1900 to 1914, were based on three main lines of development:
(a) New inventions—electricity foremost;
(b) An armaments race which led to more government expenditure;
(c) A high degree of liquidity—due mostly to increasing gold production from the Transvaal.

Now we have a situation with
(a) An astonishing spate of new inventions and methods both in industry and agriculture—not only electronics and atomic energy, but new techniques in most fields;
(b) A high level of armaments and increasing government expenditure even in other fields;
(c) Not a rate of gold production which is increasing relative to the world's gross national product, but other factors which contribute strongly to international liquidity: in the first place the regular flow of U.S. expenditure abroad, but also still some liquidity left over from the war, e.g., the high level of sterling balances.

When there is a cyclical boom superimposed on a long-term upward trend, there is, as there was from 1900 onward, a strong tendency to a sustained rise in prices. You will remember that from 1900 to 1914 prices rose by over 20 per cent.

Controlling the Boom

The question has arisen in Europe, as it has in the United States, whether the ordinary means of credit policy suffice to moderate the boom and to arrest the rise in prices under present conditions. This is not a new question. I remember my professor in Upsala, David Davidson, telling me in the summer of 1914—i.e., before World War I—that in his opinion it was very doubtful whether an increase in discount rates would suffice to keep within bounds the kind of boom that had disturbed the world in the years 1906-07. It is true that we have now more refined methods of credit policy at our disposal: we have open market operations and we have selective credit controls, which in the United States take the form, for instance, of marginal requirements relating to stock exchange credits. In Europe we have also, to a greater extent than in the United States, control over installment credit. But even so, there is
every reason to raise the question: "What can be done to moderate the boom?"

In the first place it may be pointed out that part of the present doubts as to the efficacy of the methods of credit policy must be seen against the background of the success which those methods had in combating the Korean boom. After all, once credit policy had been stiffened in 1950-51 both on the continent of Europe and in the Anglo-Saxon countries, prices began to fall and deficits in the balances of payments disappeared. Why could not that success be repeated? Mr. Butler, as Chancellor of the Exchequer, seems to have been convinced that a method of intervention had been found that would put the British position right. He suffered many disappointments!

In this connection we have, however, to ask ourselves what was the precise character of the Korean boom. The answer is that it was an inventory boom; those merchants and industrialists who were afraid in 1950-51 that many commodities would be in short supply laid up increased stocks. If one could make it difficult for them to finance the stocks, indeed, if one could force them to sell out, the trick was done; and, with the hostilities in Korea turning in favor of the West, the inventory boom was soon mastered and prices began to decline (which itself arrested further purchases) to an average level only a little higher than the one prevailing before the outbreak of the Korean conflict. It should be noted that it is not so much the increased rate of interest that has been of importance, but rather a question of the availability of credit; those who built up stocks had to be made to feel that they could not obtain further finance, but would have to repay part of the credits they had already obtained.

In the Federal Republic of Germany in 1951, merchants were squeezed so effectively that the black market rate of interest in Hamburg rose to as much as 34 per cent. That could not go on; stocks had to be sold. In the Netherlands and the United Kingdom statistics show what a great role the building up or diminution of stocks has played in the internal finances and in the balance of payments.

Here, perhaps, it is of importance to point to a difference between the United States and Europe. For the United States, balance of
payments considerations play only a minor role. However, in a European country, when there is a deficit in the balance of payments, purchases of foreign exchange from the central bank have an important contractionary effect on the money supply. If the replenishment of the money volume by new credits can be prevented, the squeeze is on. Latin American countries are in this respect nearer to Europe.

Now we have a boom of quite another character. What we now have is a typical investment boom, such as Gustav Cassel described in *The Theory of Social Economy* published during World War I. Knut Wicksell, who was very critical of Cassel, thought that this was Cassel's greatest contribution to economics. Such a boom is the result of increased outlay on plant and equipment—on houses, hospitals, roads, and holiday resorts. The most pronounced increase is generally in private investment, but governments contribute also. Let me give you some figures. In the OEEC countries, gross domestic fixed capital investment rose from 16.7 per cent in 1950 to 18.4 per cent in 1955 and 18.9 per cent in 1956. The proportional increases were even higher for certain types of investment. The boom in Switzerland has led to the absorption of 360,000 foreign workers, and in agriculture the country has reached the margin of cultivation. The demand for capital at home has been so high that even in a country with such thrifty habits as Switzerland there has been no export of capital since the middle of 1956. A similar picture can be seen all over the world. There are terrific forces at work, and this is something very different from an inventory boom.

**Fiscal Measures Needed**

Now what should one do in such a situation? The most immediate answer is naturally that one has to use credit policy as far as one usefully can but add to it fiscal policy. In the depression of the 1930's, when the difficulty was how to find a remedy against the widespread unemployment, the theory of compensatory budgets was evolved. According to this theory, government expenditure ought to be increased in periods of a small volume of private business investment, while conversely government expenditure should be curtailed when private business investment has risen and remains on a high level.
It seems that the authorities are quite ready to accept and apply the first part of this theory—the increased spending in a depression—but that they show great hesitation and unwillingness to carry out the necessary retrenchment in a period of boom.

There are, however, some countries which recently have curtailed their current government expenditure: Austria is a case in point. The interesting thing is that countries which have reduced their public investment expenditure have noticeably profited from it. In Austria there was a surplus in the balance of payments in 1956, after a deficit in 1955. Indeed, one may say that, given a reasonable credit policy today, it is the outcome of the budget that determines the order or disorder in the monetary conditions of a country.

In a speech in Hamburg three and a half years ago, I said that there is an inner connection between the surplus in the German budget and the surplus in the balance of payments leading to increased monetary reserves. It has been relatively easy for Germany recently to realize the budget surpluses since the country has had little defense expenditure; for several years the amounts voted have not been spent, and have accumulated with the Bank deutscher Länder. Increases in monetary reserves are investments like other investments and have to be matched with savings. If, as in Britain, the savings are used for investments in the sterling area, nothing remains for the building up of reserves.

The BIS shows in its last annual report that the great advantage of Germany has been the high rate of its savings, including the savings in the public sector, while in France there were no savings in the public sector. For France to promote development plans via the budget without orderly government finances is, as we know, leading to grave monetary difficulties.

It is not only in France but also in other European countries that expenditure in the public sector needs overhauling. Mr. Macmillan has begun the task in Great Britain—not without effects on the military budget. Denmark has a retrenchment program and so has Finland. There is little doubt that this movement will have to be generalized. Will it be enough? That is the question.

Note that I have referred to expenditure in the public sector. It is a question of public undertakings: railways, gas works, electricity
works, as well as budgetary expenditure proper. It is being increasingly understood that such government undertakings should not only cover their current expenses but be able to contribute to their own investments and thus not simply absorb savings from other sectors.

Similar considerations apply to the housing sector. To get rid of artificial pricing in this sector is one of the main objectives in many countries. Income from houses ought to contribute its share to the volume of savings. The housing sector is too big a portion of the economy to be exempted from the ordinary market rules. In Great Britain, houses are being gradually freed from control. In Sweden and the Netherlands, rents are being increased.

One important aspect of this gradual return to the markets is that the government concern with building activity can be reduced. One cannot understand the full reasons for the mistakes made after World War II in financial policy in a number of European countries without realizing how much the actual financial policy was dictated by the maintenance of an artificial system in the housing sector. This is now beginning to be understood more widely. It is interesting to note that, in both the Netherlands and Sweden, labor is the leading partner in coalition governments. It is an interesting development that the socialists are becoming more and more convinced that the market system of costs and prices must continue in operation. The socialists may not be content with our economic system such as it is at present, but they have realized that pricing in effective markets is a very useful device. It seems that even some of the communist countries are beginning to rely more on market prices as part of their systems.

*An End of Inflation*

These developments are signs of greater realism. In monetary matters the world is becoming more sober, but will the present measures work or are we in for a new bout of inflation?

Personally, I believe that the inflation stage after World War II is coming to an end. In a number of European countries there has hardly been any increase in the money volume in 1956 and a greater decrease than normally in the first four months of 1957. These countries include Great Britain, Sweden, Denmark, Belgium, the
Netherlands, and Switzerland. The same tendency is noticeable in the United States.

One reason why the proper fiscal and monetary policies are more likely to work now than a few years ago is that the excess liquidity inherited from the war has been almost worked off. The money volume should now in most countries be in a normal proportion to the gross national product. It is true that "pools of inactive money" may still be found, and by their activation the velocity of circulation of money may be increased and thus the effective money supply increased. But there is a limit to these possibilities so long as there is no basic loss of confidence in the currency—and the money squeeze is, therefore, likely to become more effective. It may be objected that the government sector is not subject to credit policy. The answer is, of course, that in this field direct steps to curtail expenditure are required—and even here the outlook is more hopeful.

But what about cost inflation? Is there not an increase in wages which pushes up prices irrespective of the money supply?

Now one should not think that wage movements are insensitive to monetary policy, or rather to a limitation in the effective money supply. Let me give you the example of the United States.

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<th>Index of Wages</th>
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<td>United States</td>
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<td>1st quarter 1956</td>
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<td>4th quarter 1956</td>
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<td>December 1956</td>
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<td>May 1957</td>
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<td>United Kingdom</td>
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<td>2nd quarter 1956</td>
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<td>May 1957</td>
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I could quote similar examples how there are moderate increases elsewhere in Europe. In Sweden the officially agreed rise in wages has been limited to 2 per cent, but what is more important is that the so-called "wage-slide"—the increase additional to that officially agreed on—seems to have come to a stop. The absence of strikes is usually a sign that the demands of labor are being accepted with little resistance. Governments should not interfere; they should allow conflicts in the labor market to be fought out without undue pressure on either side. Labor admittedly goes too far in some
instances—particularly in the investment industries; the choice, however, is clear, between a setback to recession or moderation in demands. Management too must show moderation.

Yet, as I have pointed out with reference to conditions before 1914, there are mighty forces in motion when a cyclical boom is superimposed upon an upward long-term trend. It is, therefore, all to the good that all these problems posed by inflation should be studied, as is being done by the newly formed committee on credit and fiscal policy set up in Great Britain. Each age provides a new setting for the monetary problems, so these matters have to be examined afresh.

**Common Market Problems**

On the continent of Europe conditions vary from country to country, but now with a Common Market in the offing increased attention has to be given to the monetary problem. The truth is that a common market cannot be run without proper monetary relations between the participating countries. That was established beyond a doubt in the relations between the Benelux countries. Whereas Belgium had adopted a rather firm credit policy with flexible interest rates, the Netherlands continued to adhere to cheap money. As a result, there were no end of difficulties between the two countries; but once the Netherlands had adopted similar policies to those of Belgium, and both countries got about equally hard currencies, a number of difficulties disappeared as if by the waving of a magic wand.

The six countries of the Common Market have decided to set up a monetary committee of their own, but in the Rome Treaty it is laid down that previous international engagements are to be respected, and that means, *inter alia*, that each one of the six countries has to respect its obligations to the International Monetary Fund. In a way that should be their salvation. I know high officials who have taken an active part in the drafting of the Rome Treaty who believe that the best safeguard of the six countries in monetary affairs is that they should move in the direction of convertibility and avoid discrimination.

Now the Rome Treaty and the proposal for the formation of a Free Trade Area in Europe, following upon the European Pay-
ments Union, as part of the OEEC, are tendencies of no mean importance. You must remember that foolish Europe has almost annihilated itself in two terrible wars. Trying to analyze the causes of their own foolishness, the European countries have rightly concluded that an exaggerated nationalism and an excessive striving for sovereignty have been the main causes of these two wars. And Europe has now turned against a narrow-minded nationalism and against exclusive sovereignties to systems of cooperation and integration. We in Europe want to retain patriotism but discard nationalism. One may have different opinions with regard to the usefulness of the specific solutions which have been put forward, but no one can doubt that there is in Europe a willingness to work together never paralleled before. This is already evident in the OEEC and is now going further.

*Europe Resurgent*

Economically, there have been many Europeans who feared that when, after World War II, Europe was cut loose from its previous political dependencies, Europe would decline economically. But somehow or other the European countries seem in recent years to have held their position quite well—even Germany, still split in two parts. Modern inventions appear to have favored Europe. Let us begin with agriculture: new methods have greatly increased the output. Great Britain itself produces over 50 per cent more than in the 1930’s. In most other European countries there already has been, or could be, a similar increase. As far as industrial raw materials are concerned, many substitutes have been invented—aluminum and artificial fibers to mention only two of the most important—which have greatly reduced the raw material content of manufactured products. This has not been so satisfactory for the producers of raw materials, but it has certainly been beneficial to Europe’s industrial countries. It is true that there is still the problem of oil, but we do not yet know what atomic energy can do.

In manufacturing, moreover, it seems that many of the new inventions—electronics, etc.—can best be utilized in the already industrialized countries. So the Europeans begin to realize that economically they may still hold their own. They must not make wars again, and they must not cut themselves off from the rest of the world. (We should remember that it has been the Dark Ages
in European history when Europe has been cut off from the rest of the world.) Europe must find a new system for itself, and at the same time establish new and better relations with other parts of the world.

The old age of a domineering Europe is gone for ever; a new age of a still very active—even a more active—Europe seeking new forms of cooperation in its own sphere of affairs and in its relations with other areas—that is the Europe to which, I hope, we can look forward. If Europe learns the right lessons from its experiences of the past, it can surely have a very great future.
Annual Report, 1957 *

As the Fund is a financial institution, it is natural to look in the first place to the business side of its activities for evidence of its usefulness. In the ten and a half years which have passed since the Fund began exchange operations in the spring of 1947, the total of Fund transactions in the form of drawings and stand-by arrangements still outstanding now amounts to a little more than $3.5 billion. The total amount drawn is $2.8 billion; no less than $1.1 billion has been repaid. That is as it should be, since the International Monetary Fund is, in effect, a "revolving fund." The policy was adopted in 1952 that currencies acquired by members through transactions with the Fund should be repaid within three years, with an outside limit of five years. This has in fact been done. Indeed, with only a few small exceptions, all transactions prior to 1955 have been fully repaid.

This experience therefore emphasizes that the assistance obtained from the Fund is essentially of a short-term character and must be regarded by the countries concerned as a temporary addition to their reserves, permitting them to adopt and carry out, within a limited period of time, a constructive program to restore stability and balance in their respective economies. The time thus obtained is really "borrowed time," of which the best use has to be made. The member countries seem quite aware of the relevance of such considerations; and they seem anxious to keep in close contact with the Fund as regards the measures they intend to introduce and the main lines of policy which they expect to follow. Indeed, it has become the practice of the Fund that, in all cases of major assistance, the main lines of financial policy of the country turning to the Fund are laid down as part of the preamble to a stand-by arrangement, or, in the case of a drawing, as a "declaration of intent" on behalf of the government of the country concerned. In that way, the broad features of the policies which can ensure a rehabilitation of the payments position are set out concisely and authoritatively.

It has been the experience of the past, and is likely to be the case again in the future, that the Fund’s business activity will vary a great deal from one period to another. There were a number of years in which central banks and other monetary authorities were able to add substantially to their reserves, benefiting not a little from the flow of funds connected with the Marshall Plan and other forms of U.S. aid. For the Fund, these were lean years from a business point of view, but they were filled with activities of other kinds. Research was started, publications were issued, and contact was established with other international institutions, whose representatives we are glad to have among us here today. The Articles of Agreement prescribed that five years after the Fund began operations those members who still retained exchange restrictions should consult annually with the Fund; as things now stand, this means that annual consultations are carried out with four fifths of all the member countries. These consultations are not confined to the particular field of exchange regulations but have developed into a review of the countries’ fiscal and credit policies against the background of their economic situations. There is now a much wider degree of freedom from exchange restrictions, especially on current account, than there has been since as far back as 1940. A majority of countries are now succeeding in making monetary and fiscal policy the principal means of dealing with their payments problems.

**Policies for Drawings**

Another matter to which much attention was given in the years of little business activity was the formulation of principles to govern the use of the Fund’s resources, i.e., the principles for the granting of Fund assistance. It has been during the active period of the last 12 months that these principles have been put to a practical test, and the experience of those months has conclusively shown how valuable they are. If it had not been for the agreed acceptance of those principles, it would hardly have been possible to deal so harmoniously and expeditiously, as was the case, with the many requests brought to the Fund during the period in question. Great use has been made of the two forms of assistance, direct drawings and stand-by arrangements, and care has been taken to secure,
in each case, the degree of justification that has to be furnished in
accordance with the policies relating to the different tranches of the
quota.

Perhaps it is useful to state once again what these policies are:
access to the gold tranche is almost automatic; and requests for
drawings within the next 25 per cent (the so-called "first credit
tranche") are also treated liberally but, even so, such requests will
be approved only if the country asking for assistance can show that
it is making reasonable efforts to solve its own problems. For
drawings beyond that tranche (i.e., beyond the first 50 per cent of
the quota), substantial justification is required, and among the
justifications foreseen are transactions in support of the establish­
ment or maintenance of convertibility. At the time when these
principles were set down and recorded in the Annual Report for
1955, convertibility seemed to be a more immediate possibility
than afterward has been the case. The 1957 Annual Report, which
is presented to you today, explains in somewhat more detail that
requests for the use of the Fund's resources beyond the first credit
tranche "are likely to be favorably received where they are intended
to support well-balanced and adequate programs which are aimed
at establishing or maintaining the enduring stability of the cur­
cencies concerned at realistic rates of exchange, and may therefore
reasonably be regarded as establishing the conditions for substantial
progress toward convertibility." These principles naturally guide
the Board of Executive Directors in their decisions, and they also
serve to indicate to the various member countries under what
conditions they can count on assistance from the Fund. As regards
requests for assistance beyond the first 50 per cent of the quota,
it seems reasonable to assume that individual countries will hesitate
to turn to the Fund with such requests unless they are ready to
put into effect a comprehensive program which will, in particular,
maintain or restore sound monetary conditions.

The sudden spurt in business activity for the Fund, which began
in the autumn of 1956, has continued up to the present. In the
period from October 1, 1956 to September 16, 1957, total draw­
ings amounted to $1,477 million, and by the end of that period the
nonutilized stand-by arrangements still stood at a figure of $874
million. In the nature of the case, each request for assistance will

1 Annual Report, 1957, page 120.
reflect the particular conditions of the country making the request, but there are also some general circumstances and developments of which account has to be taken. The Suez affair was a circumstance of that kind; it put pressure on the reserves of several countries in Europe, the Middle East, and the Far East. From an economic point of view, however, the disturbance was less than had been originally feared. It is true that the flow of goods through the Canal was interrupted for several months, but there happened to be an exceptionally mild winter in Europe which lessened the need for fuel, and it was often possible to find other outlets for exports and other sources of supply.

A development of a more fundamental nature was the growing shortage of capital and the stiffer credit conditions, which, in the course of 1956, became characteristic of the world's principal money and capital markets. It is, for instance, interesting to note that no single important foreign loan was floated on the Swiss capital market from the middle of 1956 to the middle of the following year. As it became more and more difficult to borrow abroad from private sources, countries in need of funds naturally turned to official institutions with requests for credit facilities. It may be difficult to tell in an individual instance to what extent such general considerations have influenced the decision to come to the Fund, but there is undoubtedly a connection between the changes which have occurred on the money and capital markets and the increased activity of the Fund.

Four Types of Need for the Fund

To gain a clearer understanding of the circumstances under which countries have turned to the Fund, the instances in which assistance has been granted may be divided into four main groups. First, there are the emergency needs which suddenly arise, as last year in connection with the Suez crisis. The most typical example of this kind of assistance is that granted to the United Kingdom in December 1956, when $561 million was provided in the form of a drawing (all of which has been utilized) and $739 million as a stand-by (none of which has been drawn). Although the British economy was basically sound, with a surplus in the current account of the balance of payments, there suddenly arose at the time of the
Suez crisis a fear that the position of the United Kingdom would be dangerously impaired, not only because of the decline in oil supplies but also for more general economic and political reasons. The wave of speculation against sterling which set in, largely in the form of shifts in the timing of payments for imports and exports—the so-called "leads and lags"—led to a serious drain on the gold and dollar reserves. It was obviously in the general interest to safeguard the value of sterling, a currency in which about one half of the world's current transactions are settled, and therefore it was important to arrest the loss of British reserves as effectively and speedily as possible. It was for this reason that the Fund's assistance was given so promptly and on such a substantial scale.

When the assistance was granted, the British Government had already made it clear, through statements in Parliament and through representations to the Fund, that it intended to avoid the reimposition of external controls, and, indeed, to follow fiscal, credit, and other policies designed to strengthen the economy, both internally and externally. Once the assistance was granted, the pressure on sterling subsided, and in the spring of 1957 the seasonal strength set in, permitting the British Government to extend the liberalization of its other imports. It is an interesting fact that the strain of the Suez crisis in no country led to any backsliding in regard to the liberalization of trade and payments. Pressure on sterling and on some other currencies reappeared in the summer of 1957, but it had a different origin; I will return to this subject later.

The countries in the second, rather heterogeneous, group are those which have experienced an increasing strain in the current account of their balance of payments, most often as a result of heavy expenditure on consumption and investment. Thus, over the last year, assistance has been granted to Argentina, Denmark, France, India, Japan, and, most recently, the Netherlands. The circumstances under which the strain developed varied considerably, but it was generally the case that equilibrium could be restored only if steps were taken to reduce the volume of spending, or at least prevent any further expansion for the time being.

Special difficulties often arise in those countries which have adopted rather ambitious development plans, since they may find it
hard to secure the necessary finance in the present period of an increasing capital shortage. In these, as in other cases, the task of the Fund, when assistance is given, is to give temporary support to the monetary reserves while the proper adjustments are made to avoid the dangers of inflationary financing. The problems arising in this connection have been frankly discussed with the countries concerned, which have fully understood the nature of the Fund's resources and for what purposes they are to be employed. There is a high degree of specialization in the functions of different financial institutions, and the differences arising from this specialization have to be recognized by those who turn to them for loans and credits.

Assistance in the third group is provided to meet temporary exchange difficulties caused, for instance, by seasonal balance of payments deficits. Such assistance has recently been received by Cuba, El Salvador, Honduras, and Nicaragua. These countries are largely dependent on one major export crop, and special needs may arise in the part of the year before the export crop is sold. In such cases of seasonal assistance, arrangements have usually been made for repayments to the Fund as soon as the inflow of export proceeds has again strengthened the exchange position, i.e., usually within a period of six to twelve months. Although the sums involved in these transactions have generally been rather small in absolute amounts, they have been substantial in relation to the quotas of the members concerned; and they do illustrate the capacity of the Fund to adapt its procedures to meet the widely varying requirements of its members.

Assistance in the fourth group has been granted for the definite purpose of backing stabilization programs, as in Bolivia, Chile, Colombia, Paraguay, and Peru—all in Latin America. While there are marked differences between the programs initiated and the conditions obtaining in these countries, there are also some common characteristics. One of the main reasons for adopting the stabilization programs has been that these countries wanted to get rid of the complex systems of multiple exchange practices which they had previously applied. To extricate themselves from these systems, they have adopted as a temporary measure a fluctuating exchange rate at which all or the bulk of their foreign transactions are settled. It is sometimes feared that the adoption of a fluctuating exchange
rate may be a way for a country to avoid taking the proper internal measures which are needed to restore internal and external balance to its economy. It should therefore be explained that, in the case of the five countries here mentioned, far-reaching measures of fiscal and monetary reform have constituted an important and integral part of the programs adopted. It is, moreover, understood that these countries will stabilize their currencies at a fixed rate as soon as practicable.

It has been an interesting feature of the financial arrangements with these countries that the assistance granted by the Fund has been combined with credits from such other sources as the U.S. Treasury or commercial banks in the United States and the Export-Import Bank.

It may be premature to judge the ultimate success of some of these stabilization programs. Difficulties of an economic or political character have sometimes arisen, and continued consultations have taken place, as provided for in the Fund's stand-by arrangements. But one thing is certain: in these, as in other, countries the general public is increasingly demanding a stable and reliable currency, being tired of the continuous inflationary rise in prices which often goes together with a depreciation of the national currency in the foreign exchange markets.

Multiple Currency Systems

To return for a moment to the foreign exchange systems in force in various countries: the 1957 Annual Report points out that multiple currency practices of varying degrees of complexity and importance are used by 38 of the member countries. But a gradual simplification is taking place, and it is only in about one fourth of the 38 countries that the multiple rate systems may be described as "complex." In the past year, the Fund has devoted special attention to the problem of multiple rate practices, just as in earlier years it has studied and developed policies with respect to the elimination of bilateralism and retention quotas. The experience of the Fund over a number of years has been that multiple currency practices are undesirable, not only because of the damage they cause to the economies of the countries maintaining them, but also because of the harm they often cause to the trade of other countries. Although the Fund has welcomed the progress made
toward unification of exchange rates, it has become increasingly concerned with the particular damage done by the complex multiple rate systems, where they still persist. In a decision which is recorded in this year's Annual Report, the Executive Board has expressed its desire to see more rapid progress in the simplification of these complex systems, and has stated its willingness to cooperate with the countries concerned in finding ways and means of doing so. It is prepared to render technical assistance and, whenever any proposed exchange simplification and related economic programs or measures are considered adequate, the Fund will give sympathetic consideration to a request for financial assistance.

Another aspect of the decision referred to is that the Fund will be reluctant to approve changes in multiple rate systems which make them more complex; and it will not continue to approve systems of that kind unless the countries maintaining them are making reasonable progress toward simplification and ultimate elimination, or are taking adequate measures or adopting programs which seem likely to result in such progress. The overriding consideration in all these cases is that unification of exchange rates is a basic objective of the Fund, for the Fund has not given up the hope that it will be able to witness in the not far distant future the restoration of a multilateral system of international payments with fully convertible currencies. The more numerous the countries that make their currencies freely convertible, the less easy will the other countries find it to continue to maintain complicated systems of exchange control which not only curtail the freedom of the ordinary citizen, but also enhance the danger of recurring currency depreciations, as the experiences of the past two or three decades abundantly prove. . . .

How the Fund Operates

It must be remembered that the activity of the Fund is to a large extent conditioned by the requests of one kind or another by member countries—and over the timing of such requests the Board of Executive Directors and the management of the Fund have only limited influence. In the taking of decisions resulting from these requests, questions of principle often arise of importance not only for the particular case under review, but also as precedents likely to influence future decisions. It is largely by precedents that
fair treatment is ensured and useful traditions established, both in
the national and in the international field.

In this review of problems of specific Fund activities, the subject
of Fund liquidity should be included. On September 16, 1957, the
amount held by the Fund in gold and U.S. and Canadian dollars
was the equivalent of US$2,428 million. Against that has clearly
to be set the amount of stand-bys outstanding, equal to US$874
million, since that is a contingent liability. Thus there remains a
free amount of US$1,554 million, which is still considerable,
although less than half the free amount a year ago (US$3,669
million). Even though it seems likely that some other currencies
may soon be drawn from the Fund, it is still wise to concentrate
attention on its holdings of gold and U.S. and Canadian dollars.

Since the amount of the original quotas of most members was
fixed at Bretton Woods in 1944, prices have risen by, say, 40 per
cent; in addition, the volume of world trade has increased by 70 per
cent. This is a question which is, of course, kept under constant
review. It would, indeed, be a pity if the Fund's work were to
be hampered by an inadequacy of liquid resources, for it is an
institution which combines certain peculiar advantages. Because
it is a revolving fund, the resources allotted to it will do service
again and again over the years; and, since its assistance is given
to strengthen monetary reserves rather than for particular projects,
it has become the specific task of the Fund to concern itself with
the whole field of fiscal, credit, and exchange policies of the various
countries, in a general effort to restore a proper working of the
world's monetary system. These may be big words, but the basic
objectives must not be forgotten, even though for a time the Fund
may have been largely concerned with the task of limiting the
damage caused by emergencies—a task in itself of no mean impor-
tance in a disturbed world. Although it is still too early to observe
the full effect of the policy measures taken in many of the countries
that have received Fund assistance, it should be reported that,
almost without exception, most serious efforts are being made in
the various countries to strengthen their economies. If world
trade continues to expand without any dangerous decline in the
over-all level of prices, one can be reasonably hopeful that, by and
large, the present endeavors will prove successful.
Types of Inflation

In regard to the general aspects of the world economy, there are two or three haunting questions uppermost in our minds. The first is related to inflation: Will it be possible to arrest inflation and the consequent rise in costs and prices in a world so anxious for expansion in both the public and the private sector? The second question is that of the relative value of currencies with which the markets of the world have been so greatly concerned in recent weeks and months. And the third has to do with the possibilities of financing for underdeveloped countries.

While the main characteristic of inflation—an excessive increase in demand—is the same everywhere, the causes may differ from country to country. In some countries, there is still direct government borrowing from the central bank, or the extension of central bank credit on a considerable scale at the request of the government for such purposes as low-cost housing or the financing of public utilities. In such cases, we meet our old enemy: direct inflation for government account. The answer to the problem of how to arrest such inflation is simple. Direct or indirect financing by the central bank must cease, however difficult it may be politically to discard nefarious practices which have become a habit.

But there are now some countries—and they are often economically the most important—in which there has been a tendency for prices to rise even though the government budget is balanced and the increase in the money volume has been held down to very moderate proportions, about 1 per cent per annum. In these cases it is being said that the old methods will no longer work and, in particular, that an increase in the discount rate will not be of much value.

Some explanation is needed of why these doubts have now arisen. It seems certain that credit restraint, fortified by rising interest rates, proved a very effective means of arresting inflation in the Korean crisis of 1950-51, when merchants and industrialists, fearing a shortage in the supply of important raw materials, added to their inventories, with the result that prices rose sharply. The reason that credit restraint works in an inventory boom is very simple. Those who have to finance the increased holding of stocks will usually turn to the commercial banks with demands for con-
siderable amounts of short-term accommodation; in such a situation, if the central banks apply a policy of credit restraint, they usually force the holders of stocks to sell out, and in that way the boom is decisively broken. That is, of course, what happened in 1951-52, and the success then achieved greatly helped to restore repute to monetary policy after many years of defamation.

The present boom provides us with an example of a different type of inflation. This is essentially a long-term investment boom, resembling very much the increase in economic activity which in the past has been associated with the upward phase of the business cycle. In some countries, the present boom began in 1954, and in others somewhat later. It is shown in the August issue of the Federal Reserve Bulletin that in 1954-56 the output of capital goods in the United States and in Western Europe increased more than that of other goods. In those three years, the gross national product increased at the same rate in Western Europe and in the United States, namely, by 10 per cent, but the fixed capital formation increased by as much as 20 per cent in Western Europe and by 15 per cent in the United States.

Fortunately, genuine savings have also been rising in a great number of countries (otherwise it would not have been possible to sustain such a high level of investment). But even with these higher savings it has not always been easy to secure the funds needed, and there has been great temptation to turn to the banks, for both short- and long-term financing. In such a situation, equilibrium will not be maintained simply by raising short-term interest rates; the long-term rates must also rise, and, as you know, that is what has been happening in recent years. For the central banks it has then been important to take sufficient measures to ensure that there should be no undue expansion of central bank credit. In their own sphere, these measures have generally been very effective. As I have already mentioned, the money supply has increased by only about 1 per cent per annum in a number of countries, including both the United Kingdom and the United States. But in such a situation, pools of previously stagnant money may be set in motion; and, as more or less dormant deposits become activated, the velocity of circulation will be increased, and in that way also the effective money supply. There is, however, a limit beyond which the velocity of circulation cannot increase in countries where confidence in the currency has been maintained. Also, in some countries,
recent increases in the cost of living may be regarded in part as a belated adjustment to earlier inflation, in that the cost of living indices have shown a smaller increase than wholesale prices, when compared with prewar conditions. It is also of considerable interest that, for some time, commodity prices have been falling on the world markets and that the quotations on stock exchanges have been characterized by pronounced weakness. The question has been raised how it is possible for the tendencies revealed in the falling prices of wool, copper, lead, and zinc, and the weakness on the stock exchanges, to be reconciled with the idea of a persistent inflationary boom. Clearly the present situation is not all of one pattern; it is a spotty one; there are, indeed, some signs that inflation may no longer be dominating the whole economic trend. We seem to be in a position which, according to past experiences, is likely to occur when an investment boom has gone on for a certain number of years. Then the increased supplies resulting from past investment begin to reach the markets, acting as a strong counterweight to the remaining inflationary pressure. But there are, at the same time, large amounts of investments already launched, and not yet completed, which will need further financing—often on a considerable scale.

The demand for funds, including the demand for bank credit, will therefore persist, and there is also the danger that the expectations of industrialists, merchants, and workers, nourished by many years of a prosperous boom, will remain too optimistic. In these circumstances, the timing of the measures to be taken in the different countries may not always be the same. In one country, it may be necessary to continue a restrictive credit policy until the expectations of continued inflation have been eliminated. In other countries, the time may already be ripe for some relaxation of restrictive measures. Not a little will depend upon the attitude of labor, for, in such an uncertain situation, it is particularly necessary to guard against further sharp increases in costs, lest any subsequent adjustments be unduly painful.

For my own part, I cannot help thinking that the complaints which one hears on all sides against the application of restrictive credit policies are in themselves evidence of the fact that these are really effective, even in conditions of today. They have, of course, to extend to the long-term field, and they must bring about a real limitation in the availability of credit, which will not be to every-
body's liking. But if sufficient determination is shown, and comple­mentary measures are taken in the fiscal field, there is every reason to believe that the credit policies now adopted in a widening circle of countries will prove successful. May I add just one word to stress that, when the tide turns, there must be sufficient flexibility in the minds of those who determine monetary policy for money rates to be eased and the other restrictive measures to be relaxed at an early date in order to avoid any unnecessary strain.

Relative Value of Currencies

In connection also with the second question, relating to the great nervousness recently felt in the foreign exchange markets, especially in Europe, I should like to refer to some past experiences. When we cast our minds back to the years of the gold standard, before 1914, we are often inclined to forget that there were also then, from time to time, moments of crisis when an individual currency was exposed to great pressure, as sterling was during the Baring crisis in the 1890's. But that crisis, and others of the same nature, were overcome by the application of vigorous monetary measures—in particular, by sharp increases in interest rates—and by the manifest readiness to meet the demands made on the exposed currency. Once such a crisis was successfully overcome, confidence in the currency could be expected to increase, since it had shown that it could stand the test of the pressures made upon it. In the same way today, if we can ride out the storm that has recently been raging, we shall have laid the ghost of monetary troubles so frequently connected with the month of September, and we shall thus have helped to base the currency structure of the world on more secure foundations.

Before 1914, it could generally be taken for granted that on a trading basis the individual currencies were fairly well in line with each other. But after such an upheaval as World War II, it necessarily takes some time before stable relations are re-established. Twelve years, however, have passed since the war ended, and I believe that recent movements have been largely in the direction of a more balanced position. So far as comparisons of wage costs are concerned, if account is taken not only of the money wages received by the workers, but also of the additional social contributions paid in by the employers, it seems that the remaining differences are fairly well in line with what can be regarded as a tolerable state of affairs between the various economies. Also, in the field of money
supply, much progress has been made toward a better balance. Let me quote only two figures: since 1949, the money supply has risen in Great Britain by 10-12 per cent, and in the Federal Republic of Germany by 130 per cent. The British had no doubt too high a money supply in 1949, but the way in which they have since held it down, largely by the difficult task of almost totally limiting any increases in bank advances, has revealed their determination to maintain the value of their currency. On the basis of present indications, including the realization of a surplus in the current account of the balance of payments, sterling is certainly not overvalued at its present parity. When exchange rates are on a realistic basis, there is great wisdom in strongly defending the existing rate structure. Such defense may require very stiff measures for a time, but that is better than to take the easy way out and fall into habits of currency devaluation which it may be exceedingly difficult to break.

In determining the actual credit policy to be pursued in a country, account must generally be taken not only of the need to react to the different phases of the business cycle, but also of changes in the balance of payments relations to other countries. In a boom, for instance, there will generally be a stiffening of credit policies in all countries, but some countries will be adding to their exchange reserves while other countries will be losing foreign exchange. Those who lose exchange will, as a rule, have to stiffen their interest rates and apply other forms of credit restraint more vigorously than those that are able to add to their reserves. It will generally be a delicate matter to decide how much consideration should be given to each of these factors. But under the reign of the gold standard, it was because account was taken of both factors—fluctuations in the business cycle and relative changes in reserves—that balance in the world's monetary structure was maintained for such a long period.

**Significance of Interest Rates**

Last week we had a spectacular illustration in Europe of the attention fortunately still given to the changes resulting from a flow of funds in the determination of credit policy. As you know, Germany has been adding to its monetary reserves while sterling has been under pressure. Last Wednesday the German central bank reduced its discount rate from 4½ per cent to 4 per cent, and the
Bank of England on the following day increased the bank rate from 5 per cent to 7 per cent. As far as sterling is concerned, it is well to remember that the present speculation mostly takes the form of merchants either delaying or speeding up their payments, and in both cases they will usually need to rely heavily on bank credit. When the cost of such credit is suddenly increased by as much as 2 per cent, which is what will happen in many cases as a result of the rise in bank rate in London, there is every reason for those who utilize the credits to reconsider whether the cost of shifting the date of payments has not become too great now that the British Government has so clearly shown its determination not to alter the exchange rate. This determination has been shown not only by indicating its agreement to the increase in bank rate, but also by a series of measures including cuts in the volume of public investment.

The Federal Republic of Germany, on the other hand, has become an increasingly strong creditor with large additions to its reserves, not only as a result of a balance of payments surplus on current account, but also because of movements of funds owing to the widespread expectations of a revaluation of the deutsche mark. The authorities in Germany have made it clear that they have no intention of altering the value of the mark; they have, moreover, in recent months taken measures of different kinds designed to reduce their balance of payments surplus, including the lowering of bank rate last week, a step which has not only reinforced their announced determination not to revalue the mark, but will also serve as a stimulus to internal activities. The persistent growth in Germany’s creditor position has come rather as a surprise to Germany itself; and in some respects, as in the question of capital exports, neither the German authorities nor private interests in Germany have as yet been able to provide for the further measures which are likely to be needed. They are surely most anxious themselves that, as far as it depends upon them, their strong creditor position should not expose the monetary structure in Europe to any undue strain. The growing knowledge that there will be no alteration in the value of either the deutsche mark or sterling should in itself have a calming effect on the movement of funds.

My experience recently has been that, in many parts of the world, there are what I regard as misconceptions about the economic strength of Europe. I have met with what I consider an
unduly pessimistic view. The figures which I have quoted here show that the rate of fixed capital formation is higher in Western Europe than in the United States. During recent years, an improvement has been evident in the economic life of France, Italy, Germany, the Benelux countries, Austria, and Greece, as well as Great Britain and Scandinavia. There is every reason to expect that the improvement will continue. Agricultural production has greatly benefited from modern techniques, and the output of foodstuffs in several of these countries is now some 50 per cent higher than it was before the last war. Furthermore, the increasing supplies of new commodities and substitutes, such as aluminum, synthetic rubber, and artificial textile fibers, have tended to reduce the prices of a number of materials that Europe has to import, and thus to improve Europe's terms of trade. It seems also to be a fact that several modern inventions (and not only in the fields of electronics and atomic energy) can more effectively be exploited in already industrialized countries. In spite of the folly of two terrible wars, Europe has been able to stage a remarkable "comeback" with a development that is as yet far from finished.

**Difficulties of Primary Producers**

I wish I could add that the factors which have helped Europe to recover its position have also benefited other parts of the world, but I am afraid that in some respects this has not been the case. The lower prices that many products will fetch, when a number of new commodities and substitutes are provided, will naturally not be welcomed by the primary producers; and the fact that the use of modern inventions will lead to extensive investments in the already industrialized countries will probably mean there will be less incentive for European and American savings to move to underdeveloped countries, except when oil deposits and other rich natural resources provide a special incentive.

Mr. Cuaderno, in his address yesterday, referred to some of the difficulties of these countries. When it comes to indicating the policies they should follow, I cannot make myself believe that there can be any great merit in adopting commodity schemes involving an artificial price fixing, nor that these countries will be able to mobilize any additional real resources by a credit expansion which

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leads to inflation. Whatever advantages some countries may have gained for a time from a policy of credit expansion, they have generally found—when people have awakened to the fact that their money was constantly losing in value—that there has been a reduction in genuine savings, soon followed by a decline in the rate of growth of the national product. Having said this, I feel a little embarrassed. It is often only too easy to indicate what should not be done. With regard to positive measures, I feel that we have to attach our hopes to expanded world markets and a more coordinated relationship between the policies of the countries wanting fresh capital and those in a position to provide it. The former countries must so arrange their policies that they will continue to be regarded as creditworthy, especially since grants and loans from official sources can never be large enough to provide all the foreign capital required and, therefore, private funds must also be attracted. And the countries which can provide the capital will equally have to see to it, as some already do, that in their official arrangements and private market practices care is taken to reserve certain amounts for foreign financing in underdeveloped countries. It may be that a useful solution could be found in an association of several lending institutions and, sometimes also private industrial firms, working together with the borrowing country to establish conditions in which inflation is arrested, fair treatment given to foreign capital, and thus fresh funds, both official and private, are attracted to the country concerned. Many able persons are now devoting themselves to an examination of these problems. While it would be unfair to say that a great deal has not already been done, there is hope that with goodwill on all sides more significant results will be achieved in the future.

It is a disturbed year that we have behind us, not only in monetary affairs but also in the political field. It is reminiscent of 1848, when sudden outbursts of unrest, seemingly unconnected with one another, appeared in different parts of the world. In periods of this sort, such stabilizing influences as can be provided are needed more than ever. It is our hope that some of the assistance granted by the Fund has acted as a stabilizing factor in the past year. We also hope that the present meeting here in Washington will help to dispel the doubts and uncertainties which still trouble us in the field of foreign exchange, and that it thus will exert a decisively stabilizing influence.
The Fund in 1957/58 *

The members of the Fund have agreed, in the Articles of Agreement, to a code of rules relating to certain aspects of their monetary conduct and to the creation of an institution, the Fund, to administer this code. In summarizing the powers and duties entrusted to the Fund by this Agreement, it is important to remember, in the first place, that the individual members have agreed to consult and seek the approval of the Fund, on whose Executive Board they are all represented, on certain matters which in the past have been subject only to the decision of the individual members themselves. Thus, members must consult the Fund on all changes of par value and, except in a few minor instances, must obtain the concurrence of the Fund; for changes in all other exchange rates the member must obtain the prior approval of the Fund. In the case of countries which apply exchange restrictions, the Fund may, moreover, withhold approval or set limitations to any approval it gives to restrictions imposed on current payments, or to multiple currency practices or discriminatory currency arrangements. In connection with the GATT, the Fund may determine whether the trade restrictions maintained by a contracting party exceed what can be justified by its balance of payments position. The formulation of such determinations is an important task which has already required action by the Fund.

These are only examples of what the Fund may do; it also has other powers. I think it fair to say that in using these powers the Fund always takes into consideration both the general situation and the difficulties peculiar to each individual country. Gradually, however, general policies and principles have been formulated; last June, for example, a statement on multiple currency practices was approved by the Board of Executive Directors. There is no doubt that the various countries concerned increasingly realize how harmful, not only to others but especially to themselves, is the

* Address before the UN Economic and Social Council, New York, April 16, 1958.
1 Annual Report, 1957, page 161; Selected Decisions, page 86.
distortion of prices and trade brought about by complex multiple currency practices. The improvement we have been able to notice so far, in these practices, is being somewhat retarded by the decline in the prices of primary products, but there is every reason to think that the countries in question are anxious to simplify their exchange systems.

The second important function of the Fund arises from the obligation of virtually all members still having exchange restrictions to consult annually with the Fund on the need for the retention of these restrictions. The work required in connection with these consultations—over 50 countries are at present required to consult the Fund—represents a very considerable portion of the current activities of the Fund. Obviously, the need for exchange restrictions in a country cannot be assessed without a study of the whole complex of financial and monetary developments, including such aspects of national policy as the budget, credit policy, development plans, and even prices and wages, as they affect the country itself and its international monetary relations. These consultations often require the cooperation of many officials of the countries visited, but I am glad to be able to say that they seem not to be regarded as a burden; on the contrary, information is readily given and, indeed, a genuine welcome is generally extended to the Fund officials entrusted with the task of consultation. For the Fund itself, the contacts established through these consultations have proved of great value in all departments of its work. The consultations often lead both the officials in the countries visited and the Fund itself to the conclusion that financial or technical assistance is required.

Indeed, the provision of technical assistance is a third, and increasingly important, function of the Fund. It has been found that an objective international official with the required competence can often play a role that would be well-nigh impossible for any national official, however qualified he might be technically. In some instances, at the request of the member country concerned, it has been found possible to send an official of the Fund as a technical adviser for periods of six months or more; at present, seven officials are on assignments of this sort. The Fund has even accorded technical assistance on request to a few countries which had not yet become members of the Fund.
Fourthly, I want to mention the influence the Fund may exert in other ways on general policies, and even on world opinion in monetary matters. It may do so by its reports and by the studies of its Research Department, published or only communicated privately to the member countries. The Fund may, under certain circumstances, take even more definite steps under its Articles of Agreement in commenting on current policies. Furthermore, it must be remembered that the Fund is a body of experts in permanent session. There is thus constant opportunity for following developments and discussing policies in the light of them. Once a year, the Board of Governors meets to survey the actions of the Board of Executive Directors and to give guidance. Annual meetings of the Fund may, therefore, provide a sounding board for statements defining policy, either with reference to a particular situation or of a more general character.

**Capital Flows and Currency Values**

There was an interesting case of that kind at the Annual Meeting in Washington last September. In the months preceding the meeting, an acute tension had arisen in the European foreign exchange markets. That was at the time when the 1956-57 boom had reached its climax and when, as is typical in such a situation, there was a dearth of credit everywhere—the strains that resulted were especially important in relation to the pound sterling because of the role it plays both as a trading and a reserve currency. At the same time, the Federal Republic of Germany, being particularly able to furnish the capital goods then greatly in demand, achieved a substantial export surplus, and, once the rumor had started that the deutsche mark would be upvalued, there were also large movements of foreign funds into Germany. It began to be believed, especially after the adjustment in the exchange value of the French franc in August, that there would be a general revision of European exchange rates, and, in particular, that sterling would be devalued, or at least allowed to move within wider margins on either side of par. As a result, those who had claims in sterling asked for immediate payment, while those who had payments to make in sterling delayed them as long as they could.

The resulting exceptional movements of funds, for Europe as a whole, probably totaled as much as $1,000 million. Clearly,
something had to be done, and the occasion came in connection with the Annual Meeting of the Fund and the Bank in the third week of September. Immediately prior to that meeting, steps to rectify the situation were taken in the countries most concerned.

In the United Kingdom, where gold and dollar reserves had fallen to the tune of $531 million in the three months July-September 1957, the Bank of England, in accordance with the ordinary credit rules, increased its discount rate—the bank rate—from 5 per cent to 7 per cent, while at the same time it was announced that further action was being taken to restrain private credit and limit the amount of government investment expenditure. In the Federal Republic of Germany, on the other hand, where the first nine months of 1957 had seen a net increase in official gold and foreign exchange holdings of $1,359 million (equal to about one and a half years' world gold production), the central bank reduced the official discount rate from 4½ per cent to 4 per cent—this, too, in accordance with the ordinary credit rules—and the German authorities also granted a number of foreign credits.

At the meeting of the Fund itself, statements were made by both the British and the German representatives—the Chancellor of the Exchequer, Mr. Thorneycroft, and Dr. von Mangoldt-Reiboldt—to the effect that no alteration should or would be made in the exchange parities of their currencies or in the existing margins, and to make clear that the internal steps necessary to support these parities were being taken. These statements were in line with the views expressed by me, as Managing Director, in the address with which I had opened the meeting on the same day. The markets were almost instantly impressed by these statements. Calm was restored, and from the beginning of October 1957 to the end of March 1958 the British gold and dollar reserves increased by $670 million (excluding the $250 million borrowed from the Export-Import Bank of Washington in October) while, at the same time, the German reserves declined slightly.

It should be added that no special credit facilities were granted by the Fund at the time of the Annual Meeting; proper steps were

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2 Summary Proceedings, 1957, pages 43 and 51.
3 See above, page 32.
taken, however, in the countries concerned, and the Fund meeting was used to make important declarations of policy. Without the proper steps, declarations are of no avail. But such steps being taken, the demonstration of accord at the Fund meeting impressed upon the world what were the actual policies pursued.

The Germans decided not to revalue the mark, and thus not to alter their exchange rate vis-à-vis the dollar. After the monetary convulsions of the last forty years, the public needs some relatively simple sign as an indication that a policy of currency stability is being pursued—and the dollar exchange rate is generally accepted as being such a sign. If one year the rate were to be altered to give the currency a higher exchange value, another year it might be altered in the opposite direction. That would tend to undermine confidence in the currency which is so needed to encourage savings, to make people again take out life insurance policies, and to re-establish a properly functioning capital market. But exchange stability can be pursued as a workable policy only if the individual countries—both creditor and debtor countries—take the appropriate measures at home and in their credit arrangements with other countries so as to minimize the strain to which the exchange markets may be exposed from time to time. Such action was taken in the autumn of 1957, and the results have been most satisfactory.

Financial Assistance by the Fund

After this digression I now come to the fifth, the most publicized function of the Fund, that of providing financial assistance to its members. The total business of the Fund since its inception—which can conveniently be measured by taking total drawings, together with the amount of stand-by arrangements outstanding—has amounted to $3.9 billion, of which about two thirds has taken place in the last two years.

The world boom, which had started in 1955 and continued all through 1956, reached its climax in the first half of 1957. There was a general feeling of optimism, and an all-round upsurge in investments—often both private and public—with consequent pressure on the credit structure and unmistakable inflationary tendencies. Restrictive measures had to be taken by nearly all countries; the official discount rates were increased not only in
countries with a weak, but also in those with a strong, reserve position, including, for instance, Switzerland and the United States. In those countries in which reserves were not too ample, deficits in the balance of payments brought about by the increase in internal expenditure could not be allowed to continue, particularly when foreign borrowing had become increasingly difficult. Though internal measures were taken to rectify the position in many countries, foreign credits were often needed to bridge the gap whilst the measures in question were taking effect.

Japan is a case in point. In the spring of 1957, that country introduced some strong measures to contain the boom—raising the discount rate to 8.4 per cent and arranging for an over-all surplus in the budget—and, at the same time, a drawing of $125 million was obtained from the Fund and a credit of $115 million from the Export-Import Bank of Washington. These measures were taken in a period when the upward trend of world trade, on which Japan so much depends, had already begun to weaken. Nevertheless, the measures taken by the Japanese authorities quickly had the desired results; while reserves fell by about $500 million in the first half of 1957, the decline in the third quarter, when the drawing from the Fund was made, was only $25 million, and, in the last quarter of the year, there was a gain of $83 million.

Denmark, too, turned to the Fund when it ran into a deficit in the balance of payments in the winter and spring of 1957. It decided on a series of internal measures to restrain domestic spending, and obtained $34 million from the Fund.

A slightly different case was that of the Netherlands, for in that country the drain on the reserves was attributable not only to a deficit in the balance of payments, but also to movements of funds of various kinds, including the familiar shifts in "leads and lags." The official discount rate was increased, and there was some retrenchment in the budget. The Netherlands made a drawing of $68.8 million from the Fund and a stand-by arrangement of the same amount—these two items together were equal to 50 per cent of the country's quota, as was also the case in the drawings by Japan and Denmark.

In Denmark and the Netherlands, as in Japan, it was not long before the foreign exchange position began to improve. By the
middle of March 1958, the Dutch authorities notified the Fund that they had decided to cancel the unused stand-by arrangement six months before the date that it was due to expire; and on March 31, Denmark repaid $10 million of its drawing from the Fund. These steps are gratifying as outward and visible signs of the effectiveness of the measures taken, and since they also help to replenish the resources of the Fund, which thus remains what it should be, a really "revolving fund."

Stand-by arrangements are usually granted for a period of six or twelve months, with a possibility of renewal, while amounts drawn from the Fund, whether immediately or under a stand-by arrangement, are repayable within three to five years. The advance cancellation of stand-by arrangements and advance repayments will, of course, set free resources for the Fund which, if needed, may be used in other directions.

Primary Producers' Problems

In regard to European countries generally, and also to Japan, it has, however, to be remembered that they have recently benefited from the decline in raw material prices which has improved their terms of trade. Although some of these countries may be showing losses in shipping income, owing to the low freight rates, their gain has generally exceeded the loss. The fortunes of the raw material producing countries, on the other hand, have generally been less favorable, and most of them have experienced a worsening of their terms of trade. In the last two years, the average level of raw material prices has fallen by some 15 per cent. In part, this movement is clearly of a noncyclical nature, as is shown by the fact that more than half of it had already occurred during the boom, being attributable at least in part to growing supplies of raw materials and of substitute commodities, such as artificial fibres, synthetic rubber, aluminum, etc. However, a further decline set in with the recession, which has led to a weakening in the demand for raw materials. The countries thus affected are usually those which are most intent on a rapid development of their resources, and they therefore will find themselves in a very difficult position, the more so as they often have to cope with various internal
problems of an unbalancing nature. From the Fund these countries may obtain short-term credits to help tide them over while corrective measures are taking effect, but for their development purposes they need medium- or long-term funds which must be obtained elsewhere; many of them have also to take account of the high level of maturing liabilities from past borrowings.

The Fund has been actively working for several years with some raw material producing countries. It has been able to give financial assistance, and also to help in working out programs for the strengthening, under difficult conditions, of their monetary situations. . . . In the cases of Peru, Chile, Bolivia, and Paraguay, additional amounts have been obtained from other sources, such as the U.S. Government and U.S. commercial banks, to support the programs examined by the Fund. Cooperation of this kind has proved to be a very useful development in the field of Fund activities, increasing the amounts available to the countries concerned, and widening the circle of those interested in the success of the programs which have been drawn up.

While in all these countries the ultimate objective is undoubtedly to arrive at stability of exchange rates, it has—both for internal and external reasons—not always been found possible to advance immediately to this goal. However, in these countries too, confidence in the currency has to be established as a basis for genuine savings and orderly social life, and these countries will, therefore, also have to strive for a return to conditions which will permit the stabilization of their foreign exchange rates. Moreover, it is pertinent to point out that, whether a country is operating with a fixed rate or a fluctuating rate, devaluations can never bring about an enduring balance between internal and external prices unless, at the same time, appropriate internal policies are pursued. Where the Fund has agreed to provide resources in support of a program involving the temporary use of a fluctuating rate system, it has done so as a choice of the lesser evil to be set against the harmful alternatives of complex multiple rate systems or substantial use of quantitative restrictions, and in order to allow time for the rehabilitation of the domestic situation and the accumulation of a level of reserves adequate to maintain a fixed rate. . . .
In accordance with the terms of a stand-by arrangement of October 1956, France drew, in the course of 1957, an amount from the Fund equivalent to its gold tranche and the first credit tranche; when early in 1958 France turned to the Fund with a request for an additional stand-by arrangement, it presented at the same time a comprehensive stabilization program.

Some seven or eight months earlier, the French authorities had begun to deal with certain budget difficulties, increasing taxation, and curtailing various items of expenditure. In August and October, the value of the franc was adjusted by what amounted to a devaluation of 16 2/3 per cent. Then in December, when the budget for 1958 was adopted by Parliament, maximum limits were imposed for total expenditure and for the deficit. These steps were supplemented by a number of detailed measures in the sphere of bank credit. On the basis of this program, which has been made public in France, a further credit of $131 million was obtained from the Fund, $250 million from the European Payments Union, and $274 million from various U.S. agencies (largely in the form of deferment of debt services). It is still too early to say anything definite as to the success of the program which is now being put into effect in France. There are many difficulties still to be overcome, although in some fields favorable results are already visible. On the free markets outside France, French banknotes had been quoted in 1957 at a rate as high as F 504 per U.S. dollar. The present rate is about F 440, compared with an official quotation of F 420. This result would not have been obtained if the note circulation of the Bank of France had not been prevented from rising; it is, indeed, virtually the same today as it was a year ago.

In spite of political apprehensions, European foreign exchange markets have in recent months behaved extraordinarily well. There have been no speculative movement of funds, no flight of capital, no disquieting loss of reserves, but genuine increases in the reserves of several countries. Europe’s economy tends at last to be more balanced. After twelve years of reconstruction, it seems that a more enduring stability has been achieved by the countries on that continent, and therefore its needs of assistance beyond the present limits should have been very greatly reduced.
Of the total of $3.9 billion of the Fund's business since it began operations, a little less than two thirds has been the share of countries in Europe. If the transactions represented by unused stand-by arrangements are excluded, the amount obtained by European countries is $1,650 million, compared with $1,316 million for other countries, in which case the difference is less marked. More countries outside Europe have in fact been assisted than in Europe, but the drawings of European countries naturally reflect their greater importance in international trade; and, as far as the United Kingdom is concerned, the financial implications of the widespread use of sterling extend to a very considerable number of countries, whether they are actually holders of sizable sterling balances or not. Perhaps it is also worthwhile pointing out that restored balance and prosperity in Europe is bound to react favorably on the fortunes of countries in other continents. Europe still provides important markets for materials of all kinds, and increased demand from Europe should therefore benefit producers in diverse parts of the world.

World Payments Situation

If we now turn to the world payments situation, we may find it useful to consider the developments of the last eighteen months, particularly in relation to the Suez crisis, the peak of the boom, and the subsequent recession.

During the Suez crisis, the interruption of normal supplies to Europe, especially of oil, led to increased purchases from the dollar area, and the general state of tension also gave rise to movements of funds toward that area; as a result, many countries lost gold and dollar reserves. According to the U.S. balance of payments statistics, countries outside the United States had a deficit with the United States of $1,100 million in the six-month period covering the last quarter of 1956 and the first quarter of 1957. But, in the same period, through transactions with the Fund, a net amount of $800 million was obtained by countries with strained reserve positions. The fact that the economic effects of the Suez crisis were much less serious than had at one time been feared must at least partly be due to the credit facilities provided by the Fund.

It would, however, be wrong to connect the whole of the loss in reserves in the last quarter of 1956 and the first quarter of 1957
with the commercial and other movements arising out of the Suez crisis. Inflationary tendencies also played their part, and as the boom reached its peak in the course of the following six months, they continued to affect the payments position of countries all over the world; in Europe their effect was aggravated by the tension in European exchange markets. From the beginning of April to the end of September 1957, the following three countries had payments surpluses which together amounted to about $1,600 million: the United States, $400 million; the Federal Republic of Germany, $700 million; and Venezuela, where the surplus was due mainly to exceptionally large royalty receipts, $500 million. The rest of the world financed these surpluses out of the following resources: something like $300 million from current gold production, about $600 million from net transactions with the Fund, and the remaining $700 million through net losses in gold and dollar reserves. These figures are necessarily somewhat complicated, but the next stage in the story is simpler, and in some respects rather gratifying.

Thanks to the corrective measures taken in various countries to contain the boom, and to the calming influence exerted at the Fund's Annual Meeting, balance was speedily restored in the payments position of the world. The U.S. balance of payments statistics for the last quarter of 1957 actually showed a net deficit of $248 million with the rest of the world. That deficit was, indeed, a result of the British drawing of $250 million from the Export-Import Bank; but even after this amount is deducted, the result is a balanced position. Since the end of September, neither Germany nor Venezuela has made any net addition to its reserves. It is therefore possible to conclude that the particular strains connected with the peak of the boom had been overcome by the last quarter of 1957.

By that time, it is true, the boom itself had run its course in the United States, though in Europe business activity still remains at quite a high level. No balance of payments statistics are yet available for the early months of 1958, but judging from the trade statistics and the reported movements of official reserves, it would seem that the danger of the United States building up a huge payments surplus in the recession may easily be exaggerated. This does not mean, of course, that certain groups of countries, and in
particular the producers of industrial raw materials and certain other primary producers, will not experience considerable difficulties. Some of the countries concerned have sizable reserves—in the form of sterling balances, for example—but that is not the general rule. It is, of course, one of the tasks of the Fund to be of assistance when payments difficulties arise, including those resulting from cyclical changes in international business conditions. The usefulness of whatever assistance is given will, however—in this as in other cases—depend very much upon the effectiveness of the measures taken to establish a tenable position in the individual countries. The difficulties now being experienced by these countries cannot all be attributed to the recession, since it is unfortunately the case that a number of them were already in the grip of strong inflationary pressures at home before the recession set in. If, in such a situation, no corrective measures were to be taken to eliminate or at least to reduce the inflationary pressures, the likelihood is that the assistance of the Fund would be merely of a stop-gap nature, and that the balance of payments difficulties would recur before long. For any real improvement to be achieved, the countries themselves must take adequate measures, and, if they do so under a comprehensive rehabilitation program, they can count on financial assistance from the Fund and probably also from other sources.

Much will, naturally, depend upon the course of the present recession. It seems that, in a market economy, business fluctuations are an integral part of the system; do not investigators tell us that in the last hundred years, twenty-four recessions have followed booms? In a boom, many new things are started; a point is generally reached where resources are overstrained, and productive capacity in some sectors gets out of line with market conditions. In a recession, on the other hand, with the evident need for adjustments, more attention has to be paid to cost accounting, and to the absorptive capacity of particular markets. In these circumstances, the aim must be to moderate the fluctuations by adequate policies and proper behavior, and, in particular, to avoid the emergence of a deepening depression. There are many reasons for thinking that we shall now be able to avoid the worst pitfalls of the 1930’s. There would seem to be little danger this time of the recurrence in the United States of an agricultural depression.
coinciding with the industrial downturn, such as was the case in the 1930’s—the prices of several agricultural products have, indeed, recently been rising somewhat. We should, furthermore, have wisdom enough not only to abstain from raising tariffs and imposing other obstacles to trade, but also to avoid any abrupt interruption of the flow of investment funds, remembering that in recent years such funds—whether in the form of foreign aid or of loans from various markets or institutions—have been of great assistance to the development of many countries, and to the upward trend in world trade. As far as the world’s monetary conditions are concerned, it would further seem possible to avert any serious crack in the exchange structure, such as had so great a disruptive effect when it spread from country to country in the years 1930-34. Thus if—as seems possible—we keep clear of an agricultural recession, avoid a setback to the liberalization of trade and an interruption in the flow of investment funds, and avert an exchange upheaval, we should be able to count on much more stable general conditions than those which prevailed in the early 1930’s.

That being so, it is worth remembering that past recessions, in somewhat similar circumstances, have been overcome by the interplay of a reduction of costs and an easing of money. Those industrial countries which are in a strong reserve position, and therefore able to take measures at an early date, will now find that they can ease their money conditions more effectively than in the past, and, at the same time, stimulate the active use of the available funds. But they may further find that changed conditions in their social and economic structure will stand in the way of the kind of cost reductions that occurred in most previous recessions. In some measure, however, cost reductions are still possible; and, in any case, great care must be taken to avoid any actual increase in costs. In the fluctuations of the past, periods of contraction, which have not been aggravated by particularly adverse circumstances, have usually lasted from twelve to fourteen months; if reasonable policies are followed and the proper adjustments made, we should probably be wise to adopt, for the moment, some such prospect as the most suitable working hypothesis this time. Acting on this assumption, countries need not be overalarmed by the difficulties ahead, but can continue their efforts to arrive at a balanced position. Such policies would help to prevent
a setback in those many fields in which impressive progress has been made in recent years—in the liberalization of trade, in the strengthening of the monetary structure, and in the assistance which has been given in many forms to underdeveloped countries.

Let me remind you of a saying of George Santayana: "Those who cannot remember the past are condemned to repeat it." In this century, many mistakes have been committed, but also much progress has been made. Here we are concerned with the conditions of economic life; and one of the outstanding lessons of the past is that countries cannot prosper under nationalistic policies of closed economies. It is part of the fundamental conditions of a dynamic economy in a flexible market system that, from time to time, and especially in a recession, difficulties and losses should arise which affect both the relations between countries and their own individual economies. Then, more than ever, it is essential not to be deflected from the main objectives, but persistently to pursue those lines of policy which will continue to strengthen the economic and financial structure of all our countries, and thus lay the foundations for a fresh advance in production and in the general standard of living.
The International Liquidity Problem *

In the first place, we should ask ourselves what we understand by the term "international liquidity," and, although the comparison must not be pressed too far, it is useful to draw an analogy from the liquidity position of an individual firm in the conduct of its daily business.

One might perhaps say that an individual firm remains liquid while it can without embarrassment meet its current payments, even under conditions of a general business depression and other adverse circumstances of this kind. Whether or not it is in such a position depends—apart from its general earning capacity—upon (a) The amount of cash at its disposal; (b) The nature of its assets and, especially, the extent to which some of its assets can be readily turned into cash; (c) Its creditworthiness, and especially on its capacity to borrow in case of need from the banking system. If a firm is able to borrow, it need retain less of its own assets for working capital purposes, including its cash holdings. In this connection account has, in particular, to be taken of the efficacy of the credit system, i.e., whether or not the banking system is in a position to extend credits when the need occurs; (d) Its general program of investments. In particular, to be in a liquid position the firm in question must not invest more than it can finance without dipping too much into its cash holdings or diminishing its other liquid resources.

There are thus certain conditions pertaining to the particular firm—and these are most important—but there are also some general conditions pertaining especially to the credit system, whether or not this system is strong enough to meet the demands made upon it in those periods of strain which sometimes occur. In regard to international liquidity, there is in many respects a similar position: much depends also on whether or not the international credit system is in good working order.

Speech at the Basle Centre for Economic and Financial Research, June 11, 1958.
Gold Standard System

Now I think that some useful light can be thrown on these questions if we go back to the conditions that prevailed before 1914, i.e., in the days of the gold standard system, and if we also consider to some extent the lessons of the interwar period.

One is often astonished to find how relatively slender the gold and foreign exchange reserves were in the period before 1914. The total of gold and foreign exchange holdings are estimated to have amounted to $4.5 milliard for the whole world, together with some $3.7 milliard consisting of gold in circulation. (This compares, it may be added, to gold and foreign exchange holdings today amounting to a figure of $52 milliard for the countries of the Free World; while there is virtually no gold in actual circulation, there is more gold hoarded than was ever in the hands of the public before 1914.) It is true that, for instance, France had rather ample reserves, but most countries had what we would now call very slender reserves. Great Britain, for instance, had only about £34 million (equal to not quite $165 million) in official reserves. There was the gold in circulation, but it was on the official reserves that the burden would mostly fall in case of need. Why was it that the system nevertheless worked so relatively well despite the paucity of the international reserves at the time?

In the first place, the economies of the various countries, after a long period of peace, were relatively well in balance in relation one to the other at the existing rate of exchange.

Secondly, if an imbalance occurred, the authorities and the public were prepared to apply the sometimes rather harsh rules of the gold standard in order to re-establish the appropriate equilibrium. Changes in official discount rates had undoubtedly a considerable effect when, as at that time, the public sector was relatively limited, rarely representing as much as 10 per cent of the economy (as compared with 15 to 25 per cent at present). There was much less rigidity in other ways, too, in the pre-1914 system than there is now.

Thirdly, the international credit system worked well; the strain of a seasonal or other imbalance rarely fell wholly on the reserves. There was great confidence in the stability of the various currencies,
which were almost all convertible at the existing rates of exchange; under those conditions changes in interest rates could be counted upon fairly rapidly to bring about equilibrating movements of funds. There were exceptions, of course, but they were not currencies of great importance in the field of international trade. Indeed the stability of currencies was taken so much for granted that in the years 1919-22 it took a great deal to destroy confidence even in currencies that were affected by a violent inflation.

Fourthly, the leading monetary nation—Great Britain—was a free trade country, and the commercial policies of other countries were generally pretty stable; the countries were tied together by provisions in commercial treaties for the application of the most-favored-nation clause. The result was that in a depression the deficit countries did not have to face the additional difficulty of increased barriers to trade.

Finally, the annual gold production was large enough to provide the resources for a more or less regular increase in reserves, and to give an impetus to an expansion in the credit volume. This was particularly important at the time when, through the operation of cover percentages and in other ways, the internal credit policy of the various countries was largely tied to changes in the gold reserves.

I need only mention these five conditions to make it clear to what extent the conditions and policies today are in many important respects different from those prevailing before 1914. After World War I the attempt was made to re-establish the previous gold standard system, albeit with certain changes, and it was thought for a time that the attempt had been successful but the circumstances were in important respects different so that the new system broke down, and it seems useful to try to indicate briefly why that breakdown happened.

**Why the Gold Standard Broke Down**

Probably the first reason for the breakdown was that after a world war it took more time than had been expected to restore balance in the foreign exchanges between the various economies. After World War I the values of several currencies were fixed, for more or less conventional reasons, at the prewar parities, which
proved to be out of line with the realities of the new situation. The devaluations of 1931 brought about certain corrections which, for some currencies, would probably have been unavoidable even apart from the depression. After the devaluations of 1931 a system of fluctuating rates was in some important cases adopted in place of the former system of fixed parities. The relative merits of these two systems has remained the subject of much discussion ever since. It is not difficult to imagine isolated cases when a fluctuating rate seems to be the most appropriate solution for a transitory period, but, even then, there are certain dangers inherent in the adoption of a fluctuating rate since such a rate may act as a disequilibrating factor, becoming so to say a “built-in unstablizer,” in that the rate is apt to move too far, dragging internal costs and prices with it. In any case, monetary authorities cannot wholly abstain from intervention in the exchange markets, so that they are necessarily involved. When it is possible to stabilize at a realistic rate, it seems under most conditions to be the preferable policy.

It is indeed unlikely that the general adoption of fluctuating rates would bring about a more healthy state of affairs; this certainly seems to have been the experience of the interwar period. In the years 1931-39 there was no fixed rate between the sterling area and the dollar. What then happened is often quoted in favor of a system of fluctuating rates, but there are reasons to think that such a conclusion is not as firmly based as is often thought.

In the first place, we must remember that, in any case from 1933, stable rates were maintained between the countries of the sterling area, which at that time may be said to have included the Scandinavian countries, Japan, and other countries outside the British Commonwealth which maintained exchange stability in relation to sterling. Together the sterling area countries were responsible for about two thirds of world trade. Thus, the system of stable exchange rates cannot be said to have been discarded even in the second half of the interwar period.

In the second place, it needs to be emphasized that a fluctuating rate between the dollar and sterling was, to say the least, a nuisance in international relations—the disadvantages greatly outweighing the advantages. The fact that the rates were fluctuating did not arrest the flow of gold to the United States, which at that time
moved for reasons of monetary and political insecurity. But the fluctuations in the rates were a hindrance against equilibrating capital movements, with the result that the reserves had generally to bear the whole burden of an adverse payments position.

The central banks who had to intervene in the exchange markets would seem to have been almost without exception less enthusiastic as regards the working of the system than outside persons who were not entrusted with this difficult daily task. The insiders had a feeling that every movement had up to a point a tendency to become intensified by its own momentum, and for them it was always a moot point when or when not to make a stand.

But there is a further argument which many would regard as conclusive. The system of a fluctuating dollar rate did not in fact help the pound to find an equilibrium, for if we examine closely the statistics of that period we find that Great Britain ran up a deficit on current account both in 1938 and in the first half of 1939. The dollar exchange rate was allowed to slide somewhat but no change was made in the internal credit policy, this being the time of cheap money for ever and ever. The decline in the value of the pound proved, however, ineffective in restoring equilibrium on the current account of the British balance of payments. It is not possible to tell what policies would have been adopted if World War II had not broken out, but it would be definitely wrong to infer that those directly responsible for the British monetary policy saw much merit in the system.

It might have been thought unnecessary to refer to this experience of fluctuating rates, but I believe that it is nevertheless worthwhile to underline that the interwar period produced no practicable international monetary system. Even for the sterling area there were the difficulties that I have mentioned. Elsewhere the disruption was even more marked: on the continent of Europe bilateralism in trade and payments more and more gained the upper hand, while in the United States there were still some 10 million unemployed in the summer of 1939.

It is, of course, a fact that the devaluation of sterling in 1931 was not the result of deliberate policy. The report of the Macmillan Committee (published in the summer of that year) had recommended the continued adherence to the prewar parity. But many
disturbing things happened (including the German banking crisis and, in Great Britain, the mutiny of the fleet at Invergordon), and events took charge. It is true that the devaluation brought some relief both in the domestic credit sphere and also because British prices could be divorced from the continued downward movement in the United States. It is no doubt a lesson of these times that no monetary standard can be expected to survive unscathed such a sharp fall in prices and wages as that which occurred after 1929—and it is therefore a fact of the greatest importance that there has been no general price decline in the recessions which have occurred since World War II.

The Dollar Shortage

The need for dollars which appeared after World War I and the flow of gold to the United States after 1933 are sometimes cited as examples of what later on has become known as a “dollar shortage.” Since this notion plays a great role in the discussions about international liquidity, it is perhaps worthwhile to analyze briefly this particular development of the interwar period.

In the years following a great world war, the countries most affected by the hostilities will naturally suffer from lack of resources, and it was therefore no wonder that, after 1918 as after 1945, such countries still needed dollars, i.e., the currency of the one country whose productive capacity had not suffered in the war and which therefore was able to deliver the goods required. The need for dollars arose on these occasions quite irrespective of whether there was or was not a postwar recession in the United States—there was, as we know, a sharp postwar recession in 1920-21 but no similar recession after 1945. Gold went to the United States up to 1923 but from then onward a fair degree of equilibrium was reached in the payments position, thanks, inter alia, to U.S. lending abroad. In fact, at the end of 1933, the U.S. gold holdings were virtually at the same level as they had been at the end of 1923, and in this ten-year period the fluctuations in the total had not been of any great importance. Indeed for half of the interwar period there was no drain of gold to the United States.

A new phase began, however, in 1934, for in that and the following years very large amounts of gold went to the United States almost without interruption.
It is important to note that in those years the United States had only a moderate surplus on the current account of its balance of payments—a surplus no larger than could have been met by only a part of current gold production which, at that time, was growing rapidly. The fact that in those years the United States had a larger over-all balance of payments surplus was due to the flight of capital from Europe because of the monetary, and still more the political, insecurity then reigning in Europe. The steady and substantial flow of gold to the United States in this period can therefore not be blamed on the United States, but rather on Europe.

The conception of a “dollar shortage” is dangerous, because it seems to imply that in some way it has always been the result of developments in the United States, and has thus been liable to be used as a moral alibi by those countries losing gold, obscuring the responsibility of bad domestic policies.

In periods of acute depression before 1914, when quotations on the New York Stock Exchange were declining, it was usual for European investors to sell out American securities, with the result that money flowed from the United States to Europe—a movement of funds which often intensified the credit stringency on the American markets. The outflow of funds from the United States, which has occurred again in the recession of 1957-58, thus conforms to type much more than the experience in the great depression of the 1930’s.

Lessons of Experience

What I have said so far has been of a rather negative character. But it may be asked, is there nothing that we can learn from the interwar period about the problem of international liquidity?

I have already mentioned that it is important to remember how long it takes to restore a proper balance between the various economies after a great war. There are four other lessons which I think should be kept in mind:

In the first place, there was much unwise lending, especially in the period between 1925, when a fair degree of monetary confidence had been restored, and 1930, when the Great Depression began to make itself felt.
Let us first remember that the international credit system before 1914 was, so far as short-term financing was concerned, based mainly on London, and for long-term financing mainly on Paris, but also to a certain extent on London. These centers had had the experience of international financing over a long period, and it was possible to count on a certain steadiness in their manner of handling it.

When New York took over the major role for both short-term and long-term financing in the 1920’s, it did so without having behind it any measure of similar experience. The records show that there was in these years too much short-term lending for long-term purposes, and one cannot help feeling that there were often far too sudden withdrawals when difficulties arose. What we can learn from the interwar period in this field is that the international credit system must function well for an international monetary standard to be properly maintained—a point I have already made.

It should be added that it was not only the private bankers who were also at fault; the central bankers did not observe sufficient caution but allowed in one way or another their monetary reserves to be replenished to an excessive degree by what was really the proceeds of short-term borrowing. Through the increased holdings of foreign exchange there arose, in fact, a kind of “pyramiding” in the field of reserves; when confidence began to wane the effects were spread with an alarming rapidity.

The second lesson also refers to a point made earlier; namely, that before World War I the leading monetary country, Great Britain, practiced free trade so that debtor countries in a depression did not have to face the difficulty of an erection of sudden trade barriers. The United States, on the other hand, raised its tariffs in 1930 through the so-called Smoot-Hawley Act. This was done—it may be noted—against the advice of most of the country’s economists. What followed shows that a leading monetary nation cannot take such a step with impunity, not even as far as its own economy is concerned.

The third lesson refers to the very substantial French accumulation of gold in the years 1926-30. In that period France alone absorbed the equivalent of the annual gold production of several
years. This had not been expected either by the French themselves or by others; it was connected with the undervaluation of the French franc from the autumn of 1926 when a rate was chosen that many considered possibly even overvalued. The consequences for the international monetary system of such a one-sided movement of gold were highly unfortunate, and if similar tendencies were to occur again, there are reasons to hope that more effective countermeasures would be taken.

It is perhaps difficult to answer the question whether in the years preceding the Great Depression there was a scarcity of gold, as many thought, but if one adds to the aggregate figures of gold reserves the holdings of foreign exchange, one certainly does not get an impression of a shortage of reserves at the time. The trouble was rather that the new gold, instead of spreading like a fan via the London market as it used to do before 1914, was all absorbed by one country, and also that the foreign exchange holdings which had been accumulated had not sufficiently been acquired from savings of the countries that held them, being often the result of short-term borrowings abroad. The difficulties, therefore, had little to do with the actual rate of current gold production, but more with the distribution and composition of the monetary reserves among the various countries.

Fourthly, the major disruption in the exchange structure came in September 1931. But the first crack had already started in the month of May, with the failure of the Österreichische Creditanstalt in Vienna. From this moment confidence in the international credit system began to wane, and as early as the following month the German banking system began to be affected. The crack spread with alarming rapidity, and before long there was a disruption of the whole international exchange structure with the devaluation of sterling and other currencies in September, finally culminating in the devaluation of the dollar in 1934. Such cracks may occur again; one might easily have occurred after the Suez events, but was then avoided very largely because of the financial assistance from the International Monetary Fund. It is certainly one of the primary tasks of an international credit system that it should be able to mobilize the resources needed to counter the dangerous spreading of any such crack whenever it threatens to occur.
International Economic Relations Today

Now that I have talked about the pre-1914 system and the experiences of the interwar period, it remains to examine how all this applies to the problems of today.

The first question to be considered is the extent to which a proper balance has been established between the various economies at the existing rates of exchange. There seems to be no doubt that over recent years a great improvement has been effected in the relations between the various European countries, and between them and the economy of the United States.

As far as European countries are concerned, such differences as still exist between, for instance, the wage costs in the various economies, can largely be explained by the differences in the degree of capital equipment in industry and elsewhere (when wage costs are compared, account must, of course, also be taken of the additional social charges payable in relation to the actual money wages retained by the workers). To the extent that some readjustments may still be required, they are generally of a minor nature and could be just as well effected by appropriate social and credit policies as by alterations in the exchange parities.

In relation to the United States, it is well to remember what Keynes wrote in 1946 when he said that the reaching of a true balance would be facilitated by the high cost and high living in the United States. The cost advantages of European producers were for some years obscured by the incapacity of European countries to make deliveries as promptly as the United States. But in this respect, Europe's handicap is rapidly disappearing. It seems that European countries are increasingly able to compete with U.S. products in most markets.

When, on the other hand, we turn to countries outside Europe, we still find many maladjustments which, in several instances, have been aggravated by the serious decline in the prices of primary products. Stability in some of these countries is also endangered by overambitious development plans. There is, however, even in these countries a growing understanding of the need for applying appropriate internal policies together with the acceptance of realistic rates of exchange.
In general, one may say that the authorities and the public have increasingly come to recognize the drawbacks and dangers of continuing inflation and that this has now made it possible to take measures more consistent with the pursuit of monetary stability. An outstanding example was the increase in the bank rate in Great Britain to 7 per cent in September 1957, which certainly may be regarded as a definite break with the "cheap money forever" ideas.

The second question to consider is to what extent we have nowadays a relatively free movement of goods and services.

There has been a very impressive increase in world trade since World War II, by something like 90 per cent in volume from 1948 to 1957, and there has been, at the same time, quite an improvement in commercial policy. The action of GATT to lower tariff barriers has not been negligible. The Reciprocal Trade Act in the United States has been renewed several times since the war in spite of fairly steady protectionist sentiment. Moreover, countries have learned that import controls are not an effective means of solving their balance of payments problems since such controls do not really cure the basic maladjustments but, at best, provide a temporary relief from their effects.

If one looks back over a longer period, one finds that there are quite distinct periods of fashion in commercial policy, the action of the economically stronger countries setting an example that tends to be followed rather widely. In the nineteenth century when the United Kingdom was a free trade country, free trade or rather low tariffs were the fashion. The fact that the Republican administration in the United States, with Mr. Eisenhower as President, has been in favor of a freer trade policy completely contrary to the old concepts of the isolationists, has been a matter of outstanding importance. It is no longer quite respectable to increase tariffs or apply discriminatory practices.

Part of the objective of the International Monetary Fund in granting financial and other assistance is, of course, to help to create conditions which will make it less necessary to impose quantitative restrictions or have resort to discriminations either in trade or payments.

May I again refer to the "dollar shortage." When one reads books on this subject, one often finds that the authors analyze
commodity by commodity what the United States buys from abroad or sells abroad with the conclusion, sometimes more implicit than explicit, that the United States does not really need to buy very much of what Europe can produce. One of the main weaknesses of many of these books seems to be that they pay very little attention to cost and price relations (differing in that respect from Keynes) and they fail to take account of the fiscal or credit policies of the various countries in relation to each other. There are, however, two things that I personally retain from the analysis of the more structural problems, namely:

(a) That the United States must permit imports of manufactured articles and not only of raw materials and semimanufactured goods. It is not possible, for instance, for the European countries to rely on triangular trade alone to settle balances in their payments relations with the United States.

(b) That the United States must apply and maintain a consistent commercial policy which will assure countries who develop a market in the United States that they will not suddenly be deprived of the fruits of their efforts.

We are seeing in the 1957-58 recession that U.S. imports have been well maintained and even expanded in certain lines of manufactured articles. This has been of very great importance for a number of European countries and it is very likely that the maintenance of their earning capacity will in more than one way also be of benefit to the United States itself.

*International Credit System*

I now turn to the question of the working of the international credit system. In this field, too, an improvement is noticeable; commercial credits are again being granted more readily and there has been just recently even some indication of useful equilibrating movements of funds.

When the European Payments Union began, it operated on the basis of 50 per cent of the debit balances being settled in gold and dollars and 50 per cent through the extension of credit. This was a very useful arrangement at the time when the international credit system still worked very imperfectly. Under the old gold standard before 1914, it was very rare indeed that the whole burden of a deficit would fall on the reserves, since movements of funds usually
took care of a substantial part of the imbalance. Now that commercial credits have become more easily available, the European Payments Union has been able to reduce the credit tranche to 25 per cent without any danger.

The pound sterling is used both as a trading and a reserve currency and an important aspect of its trading functions is the use of sterling credits especially for short-term financing. These functions of sterling are, of course, largely based on the efficiency of the banking system centered on London, and it is a fact of great importance that this system has been kept going without any serious impairment in the postwar period. In these postwar years, the current surpluses in the British balance of payments have had their counterpart largely in increasing the country's foreign credits and investments, and have thus, only to a minor extent, been used to strengthen the country's reserve position. In this connection we must, of course, never forget that in these matters we are confronted by the decisions taken by many individuals, with the result that it is not always so easy for the authorities to direct the flow of funds as may be sometimes assumed. But even apart from this consideration, I think that it has been a useful thing that a private credit system centered on London has been kept working in a fairly normal fashion. If the London market had no longer been a source of international credit or continued its investments abroad, the British position might today not be as strong as it is in the field of finance, even with larger reserves.

As far as the United States is concerned, the banking system today certainly pays more attention to the problems of international financing. In some fields, the position of the American banks is now predominant. This is so widely recognized that American finance has no reason to seek to eliminate competitors from other countries, but is probably rather eager to see such a center as London maintain its position as well as it can, and rather welcomes the increased position of other centers, whether in Germany, Switzerland, Belgium, Holland, or France.

Swiss banking is very greatly developed but mostly concerned with financing of Swiss ventures and participations. In Germany

1 Up to this point, this speech has been transcribed from a verbatim record. For the remainder of the text, no such record is available, and it has been reconstructed from the notes from which Mr. Jacobsson spoke.
there are high interest rates—a legacy of the past—particularly in the long-term market. The authorities want to bring these rates down, but under conditions which will not give rise to inflation. Perhaps while the present recession lasts is an opportune moment. In the meantime, the Bundesbank and the German authorities have adopted procedures which deserve recognition—taking steps to do what they can.

We are on our way to develop the private credit system, both in techniques and in confidence in currencies. All is still not well in the latter respect, as you know, but if we manage to develop the international credit system effectively we shall need smaller monetary reserves, as we did before 1914. I often see mathematical relationships worked out between the growth in reserves and the growth in world trade, the suggestion being that if the former is not as great as the latter the result is deflationary. There is no such fixed relationship—it depends largely on the effectiveness of the credit system. We must not lose sight of this essential point.

A well-functioning credit system presupposes an effective monetary policy—a willingness to take the steps necessary to correct a lack of balance when this appears. There has to be monetary discipline. It is often said that we can no longer count on the harsh application of the so-called automatic rules of the gold standard; that there is hardly any common doctrine any longer; and, moreover, that because the public sector plays a larger role there has to be more management anyhow. In this connection I would in the first place repeat what I have already said—that there is now a much greater understanding of the need for, and acceptance of, monetary discipline. This plays a great role.

The Role of the Fund

Secondly, there is the International Monetary Fund. This institution, when it grants financial assistance, is able to obtain declarations of intent and definite programs, often attached to stand-by arrangements. These may be in the nature of real rehabilitation plans for the countries concerned. A set of policies and principles has been worked out with reference to the various tranches in the quota of the Fund—the gold tranche and the first, second, and third credit tranches. For each higher tranche the requirements are a program holding out the hope of enduring stability at realistic
rates of exchange. In the last year and a half, when there have been many transactions arranged with the Fund, amounting in all to about $2 milliard, some useful precedents have been established—even some fresh principles have been formulated—and the whole system of negotiation has, I think, become accepted. I cannot pretend that adequate programs have been agreed upon in every instance, but usually something has been done. In this way the IMF, which was accused at the beginning of being an institution for the easing of monetary rules, has become an institution for the promotion of monetary discipline. In a way it can be a substitute for the rules of the gold standard.

Its action in this respect is enhanced by the fact that in several instances American aid has not been given before an agreement has been reached with the Fund. Since monetary discipline is exerted by changes in fiscal and credit policies, it would be politically difficult for the American authorities to try to exert a direct influence—there could easily be accusations of dollar diplomacy. But once an agreement is reached with the Fund, the American authorities can demand the observance of the provisions in such an agreement. From the point of view of the Fund, also, a combination with the lending activities of other agencies is very useful. A country will often need funds of various kinds—in addition to the short-term funds furnished by the International Monetary Fund, it may need long-term capital also. In all this work the Fund maintains close contact with the World Bank.

The Fund’s role will be to furnish financial assistance in connection with the observance of monetary discipline. One could have imagined another kind of institution to carry out such a task, but the Fund is there and the Articles of Agreement are sufficiently flexible to permit this essential function to be carried out. There has been much appreciation lately of this side of the Fund’s work, and it is in this connection that voices have been raised for the strengthening of the Fund’s resources.

Some countries think especially of a crack in the exchange structure. We recall what happened in 1931, and again in connection with the Suez crisis. In the latter case, the intervention of the Fund proved sufficient, together with measures in the individual countries concerned. Fortunately the Fund held a sufficient amount
of uncommitted resources as a result of its lean years (which had largely reflected the availability of U.S. aid—Marshall aid and other aid after that). It is often argued that countries' second lines of reserves should be sufficient to permit those which carry out a sensible policy to revert to convertibility. They will hesitate less if there is in the Fund a possible second line of reserves of sufficient magnitude.

One reads sometimes ideas about a return to a "Clearing Union"; but clearing is by its nature automatic, whereas the essence of the use of the Fund's resources is that it is combined with a program of rehabilitation. I can say here that changes in the attitude of some governments have resulted in almost full acceptance today of the role that the Fund has to play as an institution for monetary discipline.

The Price of Gold

These are, I believe, the lines on which people are thinking at present, but I should fail in my exposé if I did not refer to alternative proposals, connected with a possible rise in the gold price. Apart from the party chiefly interested—the gold-mining industry—there are two different kinds of economist who make proposals about an increase in the gold price:

(a) Easy-money economists, who want higher reserves to apply their policies. These are, of course, still active and still heard.

(b) Really conservative economists, who distrust all monetary management and think one should go back to the old harsh rules. They think a useful automatic impulse could come from increased gold production, by which one could dispense with the gold exchange standard, open market operations, deficit spending, etc. They hold that there is not now a sufficient supply of gold to give the necessary impulse.

When one discusses this question, one has again to go back to the conditions before 1914. Then, as I have pointed out, the inflow of gold, under the rule of cover percentages, led to an expansion of credit. (It was not quite as automatic as many textbooks tell us—but never mind.) Today the inflow and outflow of
foreign exchange still play a great role in credit policy—but generally a less precise role. For one country, however, the United States, it has for many years played hardly any role at all, as Goldenweiser pointed out in his book on Federal Reserve policy. The United States is managing its credit policy largely irrespective of gold flows. One sees it best of all now: the United States is losing gold but expanding its credit volume. There has been a loss of $1 milliard in gold and an expansion of credit by $1 milliard a month. This is important for world liquidity, since liquidity begins at home. As far as the dollar is concerned, it certainly depends on U.S. policy; one cannot create so many dollars without some spilling over to the rest of the world, and American bankers are again beginning to offer credits to other countries.

Now I cannot imagine any gold production large enough to determine U.S. credit policy. One can regard that policy as autonomous. If one then relates the annual gold supply to the needs of other countries, the supply of some $900 million of monetary gold a year is quite an amount; it will become $9 milliard in ten years. To add so much to their reserves the countries must allot savings for that purpose, and I cannot see the world devoting so much more saving to increasing its reserves. I would almost think that if the gold price were increased—say doubled—countries might hesitate to take the gold, especially if gold production were increasing at the same time. A monetary metal must be scarce; when silver became abundant, silver was discarded. After all, the use of gold for a monetary basis is a conventional matter. It might be wise of the gold-producing countries not to tempt fortune too much.

As far as current policies are concerned, I should like to point out that in 1933-34 it was the agricultural interests, with Warren and Pearson, that pressed for an increase in the gold price. Today there is a rise in agricultural prices in the United States, and I do not believe that the present recession will deepen.

* * *

So let us leave the gold price alone. What we need is a constructive policy. We must continue to bring the economies into better balance; we must develop the international credit system; we must strengthen monetary discipline; and we must reinforce the second line of defense provided by the international
institutions. It seems to me that out of this discussion of world liquidity has come a greater understanding of the real problems with which we have to grapple—problems we have known in the past and shall have with us in the future for years to come.

We may summarize the tasks ahead by saying that individual countries have—many of them—to strengthen their reserve positions, for which purpose they will need “uncommitted savings”; to accept the rules of monetary discipline and the existence of a fairly stable price level in the United States; to pay great attention to their creditworthiness; and to seek (if they are surplus countries) to cause as little damage to others as possible. Collectively, we have to strengthen the international financial machinery, both short-term and long-term, of the modern world.
When new countries join the Fund and Bank, they naturally do so because of the benefits that membership involves. Among these benefits, they count, I believe, not only the technical and financial assistance that they may receive, but also the opportunity of participating more fully in the efforts to build a new and strong monetary system in the world. No doubt, for the trend of world affairs as a whole, the economic and financial measures taken in the larger countries play a predominant role, but the larger countries themselves are fully aware of the fact that it will not be possible to bring order and harmony into a world system unless countries—large and small—adhere to some commonly evolved principles and practices. Membership in the international organizations gives the smaller countries a great opportunity not only to keep themselves better informed but also to make their influence felt, as partners in the international economy. It has been brought home to me during nearly 40 years of international service that in matters of finance—as in so many other fields—changes in public opinion are of considerable importance. The Fund has shown that in its own field it can be a powerful force for the crystallization of an informed public opinion. We had an example of the Fund’s influence in this respect at last year’s Annual Meeting in Washington.¹

Denmark, the Netherlands, and Japan ² are all countries highly dependent on international trade. They have, of course, felt the impact of the recession, but for none of these countries has there been any actual decline in exports. World trade figures which are now available indicate some decline in 1958 compared with 1957; in value, trade probably declined by about 6 per cent in the first half of 1958, but in volume by only about 2 per cent. However, it is interesting to note that exports for the world excluding the United States seem to have been fractionally higher in volume although less in value in the first half of 1958.

¹ Statement presenting the Annual Report of the Executive Directors of the Fund to the Board of Governors, New Delhi, October 6, 1958.
² See above, page 40.
The major element in the decline of world trade has therefore been the marked fall in U.S. exports which, in the first half of 1958, were 18 per cent less than in the same period of 1957. The extent of this fall, however, was due largely to abnormal circumstances in that in the early months of 1957, while the Suez Canal was closed, countries in Europe and elsewhere had to turn to the United States, to an exceptional degree, for shipments of foodstuffs, cotton, and fuel; but the fall also reflects the growing ability of European countries to meet their current needs more fully from their own production. U.S. imports in the same period declined only 2 per cent in value, while in volume they probably increased by over 2 per cent. So far as imports of industrial raw materials are concerned, the value declined, but even here the volume was fairly well maintained, although there were exceptions for individual commodities. It appears that the brunt of the reduced demand in the United States has, over a large field, so far fallen on the marginal domestic producers. Imports of foodstuffs actually rose. It is, moreover, an interesting fact that there has been no fall, either in volume or value, in imports from the industrialized countries in Western Europe and Japan. This is due partly to the maintenance of consumer demand during the recession, but it also reflects the growing proportion of manufactured goods in total U.S. imports. In that way, the United States is beginning to conform to what has, for long, been the established pattern of trade between the industrialized countries of Europe. It is relevant to recall that before 1914 Germany and the United Kingdom were each other’s best customers, and they are again increasing their mutual trade. Now that the United States has become a creditor nation in relation to Europe, it is only natural that it should increase its purchases from Europe so that the settlements of both commercial and financial obligations between Europe and the United States will be effected more as the result of direct trade and will no longer be so dependent on the often uncertain relationship of triangular trade.

The fact that so many countries outside the United States were able to keep up or even to increase their exports has been of the greatest importance, not the least from a psychological point of view. It gave countries which were faced with exchange difficulties the confidence that the maintenance of cautious policies involving a measure of restraint in their domestic economies would enable them to restore balance in their foreign exchange positions. In
Japan, for instance, as in the United Kingdom, the authorities decided that the maintenance of the present parity and the establishment of a healthy balance of payments position should be regarded as a main consideration in the formation of policy. In the first seven months of 1958, Japan's exports were 4 per cent higher than in the corresponding period of 1957 as an increase in shipments to the United States more than offset a decline in exports to Southeast Asia and Africa, where Japan's products encountered intensified restrictions; also, exports to Europe were maintained at a high level. The regional distribution of Japan's exports in this period has a wide significance. Neither in North America nor in Europe has there been, generally, any intensification of trade barriers either in the form of increased tariffs or import restrictions—although there have been a few not unimportant exceptions. It is undoubtedly true to say that the relatively liberal trade policies pursued in the present recession have reflected a better understanding of the fact that whatever may be gained in a limited field from the imposition of restrictive measures will be outweighed by the harm done to the community of nations (including the countries imposing the restrictions) through a general decline in world trade. Commercial policy must, of course, not be regarded in isolation. It has to be seen in the context of all the antirecession measures which have been taken in various countries—in particular, the easing of money (together with a reduction in interest rates) which was first applied in the countries with strong reserve positions, especially the United States and Germany. The combination of expansionary policies in these countries and the more cautious policies continued by others has, on a worldwide scale, been an example of the sort of compensatory action that is essential if a fundamental balance is to be restored under conditions of active trade and has been of great benefit to the world economy. Thanks to the substantial gold holdings which are at their disposal, the U.S. authorities have been able to ease credits, even when there was an outflow of gold. As pointed out in the Annual Report which is before you, "Whatever embarrassments the current world distribution of gold reserves may present to certain countries, it is reassuring to know that some of the large industrial countries are able to face the task of preventing excessive cyclical fluctuations without being hampered by any insufficiency of international reserves."  

For the industrialized countries other than the United States, the result of these complementary policies has been that by the end of June 1958 all but one or two of them had larger gold and dollar holdings than a year earlier. In the aggregate, the rise in the gold and liquid dollar holdings of these countries in the nine months from the low point at the end of September 1957 to the end of June 1958 has been impressive—amounting to about $2.4 billion, which more than offset the loss of about $1.4 billion in the previous 12 months. Under such circumstances, these countries in general had no balance of payments reasons for intensifying trade restrictions—which indeed helps to explain why they could maintain a relatively liberal trade policy and in some cases even widen the field of liberalized imports. It is only when trade flows freely that one can obtain a true measure of the value of a currency; and it is by continued liberalization of imports that genuine progress can be made toward convertibility.

Terms of Trade

It is, however, necessary in this connection to mention another factor which has been of great importance for the industrialized countries, namely, the improvement in their terms of trade. . . .

There is, I think, a general feeling that the problems connected with fluctuations in prices of primary products should be more thoroughly examined in their various aspects with a view to arriving at some positive solution—compatible, it is to be hoped, with the working of an effective market system. In any such examination, account should therefore be taken of both supply and demand factors (including the sale of accumulated stocks) and also of the financial implications of support schemes which in the past have often given rise to inflationary tendencies. There are many techniques now practiced which need to be reviewed afresh, including even the influence of taxation and differential tariffs on the prices of some products in the consumer countries.

The Fund in its work is necessarily aware of the difficulties of the primary producers. Their difficulties are, of course, not all due to adverse price movements; their domestic policies have not infrequently been inadequate for eliminating inflationary financing, even in years when export earnings were good and there was thus the possibility of building up reserves. On the other hand, it is only
fair to say that in the last two years there have been signs of a more realistic attitude in most of these countries; with a growing distaste for inflation, and a strong desire to avoid the re-imposition of controls, the authorities have been able to pursue sounder fiscal, credit, and exchange policies. Although the prices of their products have declined, these countries, except, I am afraid, those relying mainly on exports of metals, have had some help from the fact that the volume of their exports has generally kept up well, thanks to the effects on demand of the lower prices in the markets for their products and the maintenance of a general level of demand in a number of the industrialized countries as a result of the antirecession measures taken.

Fund Policies for Drawings

As far as the Fund's financial assistance to the primary producers is concerned, most of its transactions have been with Latin American countries. As in previous years, assistance has fallen into certain broad categories, not always sharply separated but still with certain specific features in each group. In three cases—Brazil, France, and Turkey—the use of the Fund's resources went beyond the first credit tranche and thus came within the range in which drawings are expected to be in support of a sound program likely "to ensure enduring stability at realistic rates of exchange." As in all such cases, the Governments presented comprehensive programs in which the main emphasis was laid on measures to arrest inflationary credit creation for either the public or the private sector. The stabilization efforts in all three countries also involved some adjustments in exchange rates with a view to making them more realistic. It was recognized, however, that all the adjustments which were desirable (including the return to an effective unitary rate) could not in every case be made all at once. In some instances, efforts would have to be spread over a longer period, with further steps being taken as soon as circumstances permitted, and provision was made for continuing close consultations with the Fund on these matters.

See above, pages 21-24.
Countries embarking upon stabilization programs are often in need of different kinds of foreign resources; and one of the advantages of these "parallel arrangements" is that, in some measure, they provide the countries with assistance tailored to their particular needs. The Fund's assistance, for instance, is of a short-term character (repayable within three to five years) and is designed to strengthen the monetary reserve positions; resources obtained from other agencies may be related to special categories of payments (as when furnished by the European Payments Union), or they may be of a long-term character, making them appropriate for investment financing.

Although the financial contribution of the Fund to the support of these programs has often been limited to some 20 or 30 per cent of the total amount furnished from all sources, the Fund has generally been actively concerned with the elaboration of the programs presented. Monetary problems which fall clearly within the sphere of activity of the Fund usually arise; and the various countries, moreover, seem to welcome the cooperation of Fund officials, because of their international orientation and specialized knowledge of the particular problems. The close personal contacts and intimate knowledge of conditions in member countries which have been established, largely through the Fund's annual consultations under Article XIV, have proved very valuable, in these and in other cases. The approval of drawings and stand-by arrangements is, of course, a matter for the Executive Directors, who are in permanent session. Over the years, they have evolved their own modes of work and traditions, which blend an adherence to the principles of the Fund with a flexible approach to the varying circumstances that confront them.

Whatever the Fund's special connection may have been with a country requesting assistance, it is, of course, for each agency or institution associated in these parallel credits to decide for itself, in the light of its own principles, whether to add its support on the basis of its independent judgment as to the adequacy of the program presented.

I have just referred to the annual Article XIV consultations, which constitute a very considerable portion of the current activities of the Fund. Among the other activities, I may briefly recall here
those relating to changes in par values and exchange rates, alterations in exchange restrictions, the provision of technical assistance, and the continued organization of the Fund's trainee program, which, in response to demands from member countries, has been extended in scope over recent years. These tasks are less spectacular than the granting of financial assistance, but they form a very essential part of the Fund's work.

**Adequacy of the Fund's Resources**

Now that the question of the adequacy of the Fund's resources has been raised, it is of particular interest to examine the characteristics of the Fund's various transactions in the light of the experience of the last two active years. The largest single transaction was the granting of financial assistance to the United Kingdom, in connection with the Suez events in 1956, in the form of a drawing of $561 million and a stand-by arrangement of $739 million. That the Fund was able at that time to extend assistance on a very considerable scale was due partly to the fact that the small amount of business activity in the previous period had left intact the bulk of the Fund's resources of gold and convertible currencies. Thanks to the measures taken in the United Kingdom and to the prompt action by the Fund, which was supplemented by a line of credit of $500 million from the Export-Import Bank of Washington, the position of this key currency was reinforced at a crucial moment and a major crack in the international exchange structure was thus avoided. Experience has shown (as was learned very forcibly in 1931) that once a crack starts it is difficult to limit its effect. It may lead to a series of forced devaluations of both minor and major currencies—devaluations not dictated by the realities of foreign trade and competitive prices.

The Suez emergency occurred in a period of world-wide boom, the strains of which became more pronounced in the first half of 1957, when there was a general pressure on liquidity (domestic as well as international) and a number of countries made requests for use of the Fund's resources. In fact, the largest total of the Fund's transactions to date arose in the boom period of 1956-57. It is true that since the recession set in there have also been some transactions more definitely connected with this phase of the busi-
ness cycle, but they have been for relatively limited amounts. Contrary to many predictions, neither the 1953-54 recession nor the 1957-58 recession has given rise to movements of funds to the United States; indeed, the recent recession gave rise to an outflow of gold from the United States, which in the first eight months of 1958 amounted to $1.8 billion. The interesting thing is that the Fund has been called into action in widely varying circumstances: in an emergency at the time of the Suez crisis, in conditions of boom and expanding world trade, and to some extent in the period of recession. The conclusion can be only that the Fund must remain prepared for diverse contingencies, many of which cannot be clearly defined in advance. The only thing that one can reasonably state is that in any emergency, or even in any period of exchange tension, the movements of funds that will follow are likely to be on a large scale, partly because monetary confidence has not yet been fully restored (certainly not to the extent that existed in the years before 1914 after a long period of peace and currency stability), and partly because world trade has risen in both volume and value at a very rapid rate since World War II.

It is pertinent to recall that the resources available to the Fund were determined at the Bretton Woods Conference in 1944, and that most of the data on international trade available at that time related to the period just before World War II. By 1957, the physical volume of world exports was 60 per cent higher than in 1937, and the prices of goods moving in international trade had increased by 140 per cent. The delegates at Bretton Woods may possibly have foreseen, and thus allowed for, a long-term rise in the volume of world trade, but it would seem from the records of the Conference that the delegates did not, in general, count on the considerable inflationary rise in prices which has taken place; rather, they feared a depression after the war. The result of the price rise has been that, in real terms, the Fund’s resources are now considerably less than was envisaged when its original endowment was made.

Future of International Liquidity

As regards the future trend of international liquidity, the important thing to remember is that trade, whether domestic or foreign, is financed primarily by commercial bank credit. Under a properly working credit system, backed in each country by adequate sup-
port from the central bank, credit should be able to expand sufficiently to keep pace with, and even stimulate, the growth of trade. As far as the financing of international trade is concerned, such an expansion can, however, be assumed only if, on the one hand, the necessary intimate knowledge of business conditions is extended by personal contacts between bankers and clients and, on the other hand, the general monetary conditions inspire sufficient confidence. In these respects, great progress has been made since the war. A smoothly functioning international credit system will, in itself, facilitate the task of the monetary authorities, since credits of an equilibrating character may again play the role in international settlements which they did in the past, when the whole burden of a balance of payments deficit had rarely to be met by reserve movements alone. Of special importance is the liquidity generated in the financially important countries, which will have effects beyond their frontiers; it appears, for instance, that the credit expansion in the United States during the recent recession has helped to increase the supply of dollars available to the rest of the world and has thus facilitated international settlements. But again it has to be stressed that a smooth working of the credit system, particularly from an international point of view, will be possible only if the monetary authorities themselves are in a strong position. Situations may arise—in emergencies, in booms, and in depressions—when these authorities will have need of temporary assistance. Experience has shown that there are certain distinct advantages to be gained from the provision of such assistance by the International Monetary Fund.

In the first place, the amounts made available by the Fund through drawings or stand-by arrangements are pinpointed to the particularly weak spots in the monetary structure and thus put to use where they are most needed to prevent a crack.

Secondly, the ability of the Fund to make its resources available on a large scale at one time is also of importance, since experience shows that in a period of acute tension extensive drawings will occur, usually affecting several countries at the same time.

In economics, it is the effects at the margin that count; countries must always be prepared to rely in the first place on their own resources and borrowing power. Although the supply of gold from
current production will also be a help in a general way, the difference between the ability to withstand disrupting forces and failure to do so may indeed be dependent on whatever extra amount can be made available promptly and under proper conditions.

That brings us to a third consideration, namely, that the Fund is not merely an additional source of credit for the monetary authorities of its members but is recognized more and more as a source of credit that is available in substantial amounts only to member governments that have satisfied the Fund of their intention and capacity to restore balance. It is indeed fortunate that some years ago, well in advance of the busy period of transactions that we have had during the last two years, certain principles and practices were formulated governing the use of the Fund's resources in the different tranches.\(^5\)

It is the broad purpose of the Fund to combine assistance with the observance of that financial discipline without which no international monetary standard can function properly. Before 1914, the old gold standard—harsh as it was in many ways—provided the basis for an international system under which production and trade were able to expand. It could count on general allegiance; its working depended largely upon the existence of "a few strong instincts and a few plain rules" (to quote some words from one of Wordsworth's sonnets). But the gold standard broke down in the interwar period, and its breakdown was followed by a period of monetary disruption. Something new and more firmly founded had to be built, and that was the task at Bretton Woods. More monetary management is needed today, if for no other reason than that the public sector is now more extensive than it was in the past. More time is often required for corrective measures to take effect—and to gain that time financial assistance may be needed. But without the corrective measures, assistance will be of little avail. If I may be allowed another quotation, I should like to cite some words of Clemenceau: "Liberty is the right to discipline oneself in order not to be disciplined by others." And one might add: "or to be forcibly restrained by the hard facts of life." The more that spirit permeates the member countries, the greater will be the stability of the monetary system and the easier the task of the Fund. But even so, the existence of a common pool is useful; the possibility

\(^5\) See above, page 20.
of having access to the Fund's resources may make countries more confident in their attempts to restore balance, and may indeed induce them to take stricter and more constructive measures than if they had to rely on their own resources alone.

Proposed Increases in Quotas

You have recently received a study by the staff, *International Reserves and Liquidity*, in which it is stated (page 99), "It is doubtful whether, in the circumstances of the world today, with world trade greatly expanded in volume and value, the Fund's resources are sufficient to enable it fully to perform its duties under the Articles of Agreement." It is in line with this conclusion and, if I may say so, a matter of great satisfaction that the initiative has been taken within the Board of Governors to propose that the Executive Directors be asked promptly to consider the question of enlarging the resources of the Fund by an increase in quotas.

Eighty per cent of the aggregate monetary reserves of the world (outside the communist bloc) is held by industrialized countries which also account for 60 per cent of world trade. But the other countries have large populations whose activities and aspirations are clearly of increasing importance to the world. These are generally the so-called underdeveloped countries seeking to diversify their production at the same time that they have to provide more food for their growing population. Labor is usually abundant, but other factors of production, especially capital, are often lacking. The temptation is great to rely excessively on credit creation for financing public and private investment, but experience has shown that this is a risky process; the normal rise in the credit volume which can be counted on from year to year is generally no more than enough to meet the increasing requirements for working capital of many already existing or newly formed firms, and these are very often the small firms whose activities generally provide more direct employment than large enterprises with the most modern plant and equipment. There are, in fact, no large untapped resources which can be mobilized by credit creation. Persistent deficit financing through the central bank, whether directly or indirectly through the commercial banks, is really another name for the using up of monetary reserves. Practical experience has shown this to be the case in developed as in underdeveloped countries, and whether
expansion relies on private enterprise or on government ownership and control. To promote development at a quicker pace than the underdeveloped countries’ own savings will permit, there is therefore need of resources obtained from abroad—and not only from official agencies but also from private sources. To attract such resources from private investors, countries will, of course, have to attend to their own creditworthiness. I am often asked what are the requisites of creditworthiness, and I seek to make my reply in a few words: avoidance of inflation and fair treatment of foreign investments. These are pregnant words, for avoidance of inflation means the preservation of a monetary order under which an impetus is given to both exports and internal savings, and this goes a long way toward assuring fair treatment for foreign investors and thus toward attracting foreign capital and techniques on reasonable terms.

But will capital in fact flow from the more developed countries? At the height of the 1956-57 boom, there was a dearth of loanable funds, and the opportunities for borrowing were therefore greatly restricted; but this did not last long. Were it not for the heavy burden of armaments expenditure in so many countries, more free resources for development would, of course, be available in all areas. But even in the troubled world we live in, it seems that more funds are becoming available now that war reconstruction is over and so many postwar adjustments have been completed.

This applies of course particularly to Western Europe which, barring major emergencies, should no longer, on balance, require financial resources from abroad, but rather should be able to contribute its share to the financing of countries in less developed areas. There have already been interesting examples of such financing, and more should be possible in the future.

Europe has again become an important customer for the goods furnished by other continents—and the fact that in the whole range of industrialized countries production and trade have expanded to far above prewar levels is, in itself, of great benefit to the rest of the world. But a further contribution will still be needed, and the Fund-Bank Annual Meeting here in New Delhi will no doubt help to increase the awareness of the problems and potentialities of the underdeveloped countries. I think it is fair to say that there has been
a greater recognition of the difficulties of these countries and a growing willingness to extend assistance to them; but, however much has been written on their particular problems in recent years, we have not so far arrived at a generally accepted and coherent view of the ways in which their domestic savings and available foreign resources can best be harmonized to promote development with stability. I have already referred to the need of a renewed examination of the factors influencing the prices of primary products, and here we have another complex of problems which affect the non-industrialized countries. No definite solutions are likely to be found to these various problems this week, but this Meeting here in New Delhi will, I am sure, give an impetus to the search for positive solutions; in the meantime, assistance will no doubt be continued according to the methods already employed. The strengthening of general world liquidity is, of course, a matter of importance also for the nonindustrialized countries, since it will contribute to a sustained expansion of world trade.

I have said that we live in "a troubled world" and few would gainsay that. Not only politically but also economically and financially, in recent years there has been a series of critical situations—boom followed by recession, tensions in the exchange markets, loss of reserves by many countries, and so on. If, however, we examine what eventually happened, I think we will reach the conclusion, perhaps with some astonishment, that the results in the end have not been too unfavorable. The exchange crises have been overcome; there is surely more confidence in currencies than there was some years ago; the recession has, it seems, once again been of rather short duration; international trade has not generally been hampered by new obstacles; foreign aid has been continued and efforts have been made by the Fund and others to extend financial assistance to countries in special difficulties, not only to permit corrective measures to take effect but also to enable those countries to continue their development.

We must all be prepared for difficulties; business fluctuations, for instance, are likely to occur in the future as in the past. But human beings are not powerless; by their actions, they can greatly influence the trend of affairs. There has been—and is—a more flexible and imaginative reaction in the countries of what is often called the free
world than I think is commonly realized. And I believe we may regard the proposals before this Meeting, to examine the question of an increase in the resources of the Fund and the Bank, as a further sign of willingness and determination to give added strength to the economies of the countries that are members of our institution.
When we look back upon the year that has passed since I last spoke to you, we are all aware of continued, and even increased, tension in the field of politics; but at the same time we are able to note a welcome absence of any serious crisis in the economic and financial field. That does not mean that a number of countries have not had to face considerable difficulties; the producers of primary commodities, including most of the countries in Latin America, have felt the impact of lower prices on their balances of payments; and a number of industrialized countries have had, and still have, relatively high rates of unemployment. But after allowance has been made for these difficulties, the main characteristics of the last 12 months have been the recovery from recession in the United States, the strengthening of monetary reserves, particularly in Western Europe, the moves to external convertibility by 14 European countries (which have been followed by other countries in the sterling and franc areas), and distinct signs of a renewed expansion in world trade. The industrialized countries have again shown their willingness to make capital available to underdeveloped countries; and decisions have been taken to increase the resources of the Fund and the Bank, and thus to strengthen the international financial structure. These encouraging developments could not have occurred without the adoption of constructive and determined policies.

A year ago,1 the recession in the United States still appeared to be deepening, and fears were expressed that its intensification would create serious difficulties all around the world. Now we know, however, that already in the course of the second quarter of 1958 the decline in economic activity was arrested, and by the late summer and autumn signs of renewed recovery were evident. In fact, the recession has again been of relatively short duration. By the end of 1958 the gross national product of the United States

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* Address before the UN Economic and Social Council, Mexico City, April 9, 1959.
1 See above, page 46.
had recovered to an annual rate of $453 billion (in real terms as high as the previous peak in the third quarter of 1957), consumer buying in the third quarter was 3.0 per cent higher than in the corresponding quarter of the previous year, and hours worked in industry had risen by 5.2 per cent from the trough of the recession and were as high as the average for the first quarter of 1957. Unemployment, however, at the end of 1958 was at the high rate of 6.1 per cent of the labor force, having fallen less than in the periods of recovery after the two previous recessions.

This is not the place to examine in any detail the circumstances which led to the rapid recovery. But a brief analysis would, I believe, be useful in a wider context. First, and of basic importance, is the resilience of the U.S. economy—and this includes not only the strength arising from the so-called "built-in stabilizers," and structural improvements in such fields as mortgage finance, but also the spirit of enterprise, revealed particularly in the urge toward innovation in a period of technical progress, supported by ample funds for research. To be able to exert their full influence, these more or less permanent factors must be supplemented in each phase of the business cycle by appropriate policies on the part of the authorities. So far as government action was concerned, perhaps the most important measure was the placing of increased orders for defense and other purposes in the spring and summer of 1958. In the credit field, particular importance attaches to the expansion of commercial bank credit following the relaxation of reserve requirements, certain open market purchases, and a lowering of interest rates. The total amount of credit extended by the banking system as a whole rose by $16.7 billion during 1958. This increase had its main counterparts in a rise of $5.4 billion in currency and demand deposits (including government and foreign deposits), an increase of $6.8 billion in time deposits with commercial banks, and an outflow of gold amounting to $2.3 billion.

In assessing the importance of this credit expansion, it is worth noting that from the middle of 1955 to the middle of 1957 there was virtually no change in the money supply in the United States. The prices of raw materials had been declining in spite of the boom, and surplus capacity had reappeared in several lines of business—a combination of circumstances which seemed dangerously to resemble the situation in 1927-28 immediately before the Great
Depression. While it was possible, as long as the boom continued, to count upon an increase in the velocity of circulation, once a setback in business occurred, velocity would tend rather to decline; in such circumstances, the stagnation in the money supply could easily become a dangerously depressive influence.

In the middle of 1957, conditions in the United States, and in certain other countries, were such that it could well be argued that there was need for increased liquidity—not so much in the form of reserves held by central banks or governments (what is generally called "international liquidity"), as in the form of credits provided by the private banking system, which determine the amount of cash resources within the economy. By that time the excess liquidity inherited from the war had been worked off in quite a number of countries, and there were good grounds for thinking that a fresh impetus was required through an expansion of bank credit which could gradually be transformed into effective purchasing power. It was only natural that those countries which were in a strong position, such as the United States, should have to take the lead in any expansionist policy.

It is unlikely that without the credit expansion that occurred in the United States the budgetary and other factors would have been sufficiently powerful to stage a recovery. This infusion of new money helped to keep up consumer income, and thus also helped to maintain imports at a time when U.S. exports were declining. The substantial casing of money and lower interest rates made it possible for U.S. banks to grant foreign credits more readily, and for the U.S. economy as a whole to maintain its foreign investments on a high level. Apart from their beneficial effects internally, the U.S. antirecession policies also contributed greatly to strengthening the monetary reserve positions of other countries. A number of these countries, including Belgium, Denmark, Germany, France, the Netherlands, and the United Kingdom, have been able to ease credit, in some cases with substantial reductions of interest rates, making in that way an important contribution to a renewed upturn of business activity.

Unemployment Continues

While in the United States and in some of the other industrialized countries the recovery in production has been substantial, many of
these countries have found that employment has not risen as sharply as production, with the result that unemployment has remained higher than in the recovery periods after the two previous recessions. This has been due in part to a longer average working week, but has also reflected a marked increase in productivity—both of which have meant greater production per worker employed. In itself, of course, increased productivity is a good thing, since it is an essential condition for economic growth in any society, at any time. But the question remains what measures should be taken to ensure that unemployed workers will be absorbed into useful production, a problem which is now debated in quite a number of countries.

If one examines the experience gained in past periods of business fluctuation, it is clear that no single measure can ever suffice to expand production and absorb unemployed workers. It is important to establish the conditions for a proper balance in the cost, price, and demand structure so as to ensure that the goods and services that may be produced will find adequate outlets in the markets. This will always require a combination of measures—on the one hand, a sufficient increase in the liquidity of the economy, through appropriate credit, fiscal, and other policies, to sustain purchasing power, and, on the other hand, the avoidance of increases in costs and prices that would be liable to impede an enlargement of sales. In expanding demand it is therefore wise to concentrate on those methods least likely to provoke an increase in costs and prices. Insofar as that can be achieved, the subsequent recovery will not consist primarily of a higher value of output as the result of rising prices, but rather of a steady increase in the volume of sales at relatively stable prices, thus ensuring the maximum increase in production and employment—what the Germans call a "Mengen-Konjunktur."

The Great Depression was responsible for a change in economic thought on this subject. Before the depression it was almost taken for granted that wage reductions, if drastic enough, could effectively overcome a depression and restore higher levels of employment. However, influenced by the fact that unemployment remained distressingly high after 1929, in spite of repeated wage reductions, more and more economists came to believe that wage cuts would cause a decline in aggregate demand and would therefore intensify
rather than relieve the difficulties. They also laid increased emphasis on the need for credit expansion. But this is not to say that the necessity of holding down costs was entirely ignored. Keynes, for example, while strongly recommending an increase in liquidity, at the same time laid stress on the need to avoid increasing money wages and to accept, at least temporarily, somewhat lower real wages if a depression was to be overcome. Alvin H. Hansen, in *A Guide to Keynes* (page 193), has explained Keynes' view of what the effects of an increase in costs on employment would be: “In so far as marginal cost rises as output increases, some part of the increase in Demand must be dissipated in higher prices. But if in addition money wage rates also rise, employment suffers as a result of the higher wages of the already employed workers.” This important element of Keynes' theory is frequently, and unfortunately, forgotten.

At the present time, both production and productivity are increasing in a number of countries. In the credit field, there is ample liquidity to sustain expanding production. In the United States, the money supply rose by 3.8 per cent in 1958; and the $6.8 billion of time deposits which were created in that year meant an addition to liquidity which is likely to make itself felt also in 1959. In Europe, too, the increase in liquidity is exerting an active influence. If in these circumstances costs and prices are held down, there is a very good chance that recovery will continue and unemployed workers will be absorbed into the active labor force although, as in the past, pockets of high unemployment may present special difficulties. Moreover, if there is proper restraint in costs and prices, there will be a real increase in the gross national product on a scale which will permit such an increase in the standard of living as cannot be achieved in any other way. If, however, costs are allowed to increase, the danger is perhaps not so much of renewed inflation but rather of a failure to expand production and reduce unemployment.

While leading industrial countries have not hesitated to expand the volume of credit, often on a substantial scale, as part of their policies to overcome recession, they have had to bear in mind that, once the upward trend sets in, a further increase in liquidity might well give rise to fresh inflationary pressure. A factor of some importance in many countries is a lingering inflationary sentiment,
nourished by years of rising prices; in such a situation, there is the need for a clear demonstration by the authorities that no further inflation will be allowed. From this point of view, the attainment of a balanced budget can serve a very useful purpose; moreover, when the recession is past and recovery is under way, the generally accepted principles of a compensatory budget policy call, if not for a budget surplus, at least for a balanced budget.

It is, of course, difficult at present to lay down any general rule, since conditions vary a great deal from country to country. In several countries in Europe, the recession began at a somewhat later date than in the United States and Canada, and subsequent developments have also differed somewhat. The timing of many measures may, therefore, have to differ somewhat on the two sides of the Atlantic.

**International Credits**

The easier credit conditions in Europe, which were made possible by increases in monetary reserves, have continued even after the establishment of external convertibility. This provides added confirmation that this move was made from strength and not from weakness. Already in 1955, in preparation for such a move, the Western European countries had signed the European Monetary Agreement which was to replace the European Payments Union as soon as convertibility was established. But adverse circumstances in the following two years delayed the completion of the plan. By the end of 1958, with the strengthening of their monetary reserves, many of these countries were able by a remarkable concerted action to seize the opportunity to go ahead. By taking this step, they brought closer the final move to full convertibility.

Under the European Monetary Agreement, ad hoc credits may be granted to individual countries, but the automatic credits which were a feature of the European Payments Union have now virtually disappeared. In this respect, the new European arrangement has moved closer to the policies and practices of the International Monetary Fund. Access to the Fund's resources is determined by the merits of each case. The Fund is not simply an additional source of credit for its members; its resources are available in
substantial amounts only to member governments which, in their contacts with the Fund, have shown that they have the intention and capacity to maintain or restore balance. This principle has become fully recognized in the recent active years of Fund transactions; and in this way the Fund contributes to the observance of monetary discipline, which is as important for the proper functioning of an international monetary system as for the maintenance or restoration of monetary order in each individual country.

Some concern has been expressed at the disappearance of the more or less automatic financing established under the rules of the European Payments Union. It has been argued that the automatic methods of financing had the merit of obliging creditor countries to make their contribution to meeting balance of payments deficits when a strain occurred, while the new system is liable to place an undue burden on countries whose reserves are falling. These fears, however, can easily be exaggerated, as may be shown by an analysis of the rules which now apply. Under the old gold standard, countries rarely had to meet a deficit in their balance of payments wholly by drafts on their monetary reserves. Equilibrating and other banking credits usually filled part of the gap. However, in 1950, when the European Payments Union was established, the international banking system had not begun again to function adequately. In those circumstances, it was natural that a certain degree of official financing should be made readily available to meet part of the drain on individual countries’ reserves. Since that time, banking relations have been reknit, and restrictions have been reduced, if not fully abolished, so that the orderly methods of market financing can now resume their proper role. It is in many respects appropriate to rely more on the funds available in the market than on official financing, which usually involves the employment of central bank credit, which ought not to be the first called upon for equilibrating purposes; central banks should remain the lenders of last resort.

Moreover, both the International Monetary Fund and the European Monetary Agreement have been established precisely for the purpose of assisting central banks in case of need. The practice of the Fund is that, if a member requests to draw an amount equivalent to its own gold subscription, normally 25 per cent of its
quota, the Fund gives the member the overwhelming benefit of the doubt; for the next 25 per cent, a country requesting assistance must show that it is making reasonable efforts to solve its problems. Requests for drawings beyond these limits require substantial justification, namely, that the drawing must be in support of a sound program likely to ensure enduring stability of the currency at realistic rates of exchange.

A country making use of the Fund's resources, in accordance with these principles, will invariably draw the currency of a country in a strong position. That is the contribution which creditor countries make via the Fund. But the deficit countries should also make their contribution, and this they do by correcting maladjustments in their economies by their own measures, often helped by financial and technical assistance from the Fund. A certain balance of responsibilities is thus established in the effort to restore equilibrium in the international balance of payments.

It is now generally recognized that countries in a strong balance of payments position normally have to take the lead in initiating financial and economic policies compatible with the maintenance and expansion of the volume of world trade. In the Fund's Annual Report for 1958 (page 11), transmitted to the Board of Governors in the midst of the recession, it was pointed out that "While countries with balance of payments difficulties would certainly run great risks in applying expansionary policies at such a time, countries in a strong position have a special responsibility to maintain internal demand and production at high levels, thus ensuring a buoyant market for imports and contributing to the expansion of world trade. The prevention and correction of excessive cyclical fluctuations is a responsibility primarily for the large industrial countries—a task which they should undertake both in their own interest and in the interest of the rest of the world. There will, however, be a better prospect for the success of their efforts if the less developed countries are fully aware that stability cannot be assured to them merely by the efforts of others, and that they cannot be spared the obligation to adapt their own economies to fluctuations between high and low demand." In 1958 both the United States and Germany, two countries in strong reserve positions, took steps appropriate in each case to the particular circumstances with which they were faced, and thus relieved the situation in other
countries. This was an example of the kind of complementary policy, involving measures of an opposite nature in individual countries, which is often necessary to ensure generally balanced conditions.

Problems of Nonindustrialized Countries

In recent years the distinction between industrialized and nonindustrialized countries has assumed increased significance as a result of the differential movements of prices. Contrary to what many people had expected at the time of the boom prices after Korea, the prices of most primary products have fallen, with the result that the terms of trade have improved for the industrialized countries and deteriorated for the primary producers. To some extent, the price declines have been intensified by the recession, but they should not be regarded as no more than by-products of cyclical fluctuations. The prices of many commodities have been affected by deep-seated structural changes, including a sharp increase in productive capacity and output, competition from synthetic and other products, and the difficulties associated with the disposal of agricultural surpluses in the United States.

While a recovery in world trade may improve the prices of some of these products, and in any case make it easier to dispose of stocks, it would probably be an illusion to think that the main difficulty will be overcome in this way. Many primary producers are faced with long-term problems for which the only proper solution is probably a diversification of their own production and exports; for this they will need new capital and also better technical knowledge.

At the same time, the underdeveloped countries have to take account of the demand from their growing populations for a better standard of living, the attainment of which also requires capital for investment. In these circumstances there is a strong temptation for these countries to look to an expansion of credit to provide the funds that are needed, even though such an expansion will clearly be of an inflationary nature. With the experience gained in many parts of the world, it is now possible to assess whether such policies are appropriate. Some degree of credit creation that leads to a rise in prices may indeed for a time bring forth a kind
of "forced savings," which can form the basis for industrial and other investments. But this is true only so long as the public is willing to continue holding a more or less normal amount of cash in the form of notes and so long as wage increases continue to lag behind the rise in prices. Once people wake up to the hurts inflicted upon them by inflation, they will demand increased wages, and also hasten to buy whatever they can to avoid any loss of real earnings. Not only will the forced savings then disappear, but the normal flow of voluntary savings will also be diminished and increasingly diverted to speculation in real estate and other ventures. It has been the experience in quite a number of countries, both industrialized and nonindustrialized, that when this happens the game is up, for without a ready flow of savings no economic progress can be sustained. I was interested a few weeks ago to hear a statement from a senior official of a Latin American country that it was the policy of his new administration "to put a quick end to inflation which has been holding back the country's development for many years."

One of the main considerations for foreigners when they contemplate private investment in a country is whether the country has a sound currency position. While inflation is raging, they are bound to be hesitant. What is less obvious but equally true is that public and international agencies are likely to be less interested in using their not unlimited funds for economic development in countries where inflation threatens to dissipate a large part of their effectiveness. Any country is likely to find that a continuance of inflation means diminished internal and external resources on which to base its investments and the growth of its economy. This is being more widely realized, and the eagerness with which an increasing number of countries have in recent years worked out stabilization programs and put them into effect is evidence thereof. It is difficult for governments, subject to many pressures and anxious to meet often dire needs, to evolve and to hold to consistent policies. This is a difficulty found all through the world's history. The Roman historian, Sallust, expressed it in a famous passage: *Sunt plerumque regum voluntates vehementes et inter se contrariae.* [It is the habit of rulers passionately to pursue aims that are inconsistent one with another.] But in the past it has never been wise to pursue
radically inconsistent policies, and it will never be wise in the future.

_The Role of the Fund_

The first of the Fund’s Articles of Agreement, which sets forth that one purpose of the Fund is “to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy,” shows clearly the connection between the work of the Fund and the general questions examined above. The expansion of international trade is, however, so much a product of what happens in individual countries that the Fund cannot be uninterested in the policies pursued and the steps taken to promote economic growth within each country. The Fund must also be concerned with methods of financing investment, for inflationary methods soon lead to deficits in the balance of payments, and thus to the need to take measures to correct maladjustments in the balance of payments. These problems are now foremost in men’s minds, and there is a great and growing eagerness to find the proper basis for growth combined with monetary stability. In the past year, the Fund has continued to be actively engaged in the discussion both of some of these general problems and of the problems of individual countries.

As far as this year’s transactions are concerned, an interesting feature has been that many countries have been able to repay in a relatively short time amounts drawn earlier by them from the Fund. During the 12 months from April 1, 1958 to March 31, 1959, total repayments to the Fund reached $537.3 million, while drawings came to $262.9 million. The fact that repayments exceeded drawings is further evidence of the revolving character of the Fund. However, at the end of March 1959, the Fund’s commitments under stand-by arrangements amounted to $1,157.3 million, and these contingent liabilities also, of course, affect the Fund’s liquidity position.

Since the beginning of its operations, the Fund has made available about $4.2 billion, of which approximately two thirds has been

2 Article I (ii).
provided since the autumn of 1956. Of the 41 stand-by arrangements, 29 have been with countries in Latin America.

Thanks to the efforts made in the individual countries (helped in several cases by general market developments) and to timely assistance by the Fund, it has proved possible to avoid any serious disruption in the foreign exchange structure, and also to take some important constructive steps. The experience of recent years has shown more and more clearly the role that the Fund can play as a center for monetary cooperation.

[Mr. Jacobsson then summarized the steps that followed the adoption of a resolution at the previous Annual Meeting, which instructed the Fund's Board of Executive Directors to consider a detailed proposal for an increase of Fund quotas. He went on:] the real significance of the increase is not so much in the increased capacity of the Fund to meet now foreseeable needs, but rather in the evident reinforcement that it will give to the second-line reserves available to countries which may find themselves in temporary balance of payments difficulties, especially in times of emergency which by their very nature cannot be foreseen. The very possibility of access to the Fund's resources on a more substantial scale than before should give members more confidence, and may indeed encourage them to move faster toward achieving the purposes of the Fund than if they had to rely on their own resources alone. For this reason the benefits which the Fund can provide are by no means limited to those countries which have sought or may seek assistance from the Fund. Other countries are also bound to profit, since there is a general interest in the financial rehabilitation of countries in difficulties, and in the establishment of a properly functioning international monetary system.

The Fund is not designed to take over such tasks as are properly carried out by the private banking system or the monetary authorities in the various countries, but to provide supplementary reserves in order to strengthen the general financial structure. Experience has shown that there are certain situations in which the private credit institutions in various countries cannot be expected to do the work that is needed. These institutions would find it difficult, not to say impossible, to cope with the strains of an acute emergency,

such as that of the Suez crisis, when substantial sums have to be provided promptly and at a considerable risk. In emergencies of this sort, the Fund's assistance may well be indispensable in preventing a crack in the exchange structure. Moreover, when a country is clearly in such an unbalanced position that radical measures are required to restore equilibrium, private banks may properly be deterred by the risks involved in granting it further credit facilities. In such situations, it is only if a comprehensive program is adopted and put into effect that the risk will be reduced; and private institutions are not in a position to negotiate such programs. Experience has shown that the governments in the various countries are more willing to discuss and work out stabilization programs with officials of the Fund than with representatives of other countries or of private credit institutions. While the Fund therefore often takes a leading part in working out effective stabilization programs, and also makes available resources to strengthen the reserve positions, the amounts thus obtained are often supplemented by resources from other agencies under what is called "parallel arrangements."

Alongside the granting of financial assistance and other specific tasks, the Fund has the duty to consider general monetary developments with a view to promoting international cooperation which will combine exchange stability with a balanced growth of world trade. In carrying out this task, the Fund will have to maintain close contact with the authorities in the various countries and with other international organizations. Member countries continue to show great willingness to work with the Fund and to strengthen its effectiveness, and this attitude has been reflected in the decision to increase the Fund's resources.

Although great progress has been made in recent years, many difficult monetary problems remain. The most gratifying aspects of present-day developments are the public's dislike of inflation and the more general realization of the importance of monetary stability as a basis for sustained growth. Who wills the end must also will the means; and after years of inflation, stability can generally not be attained without a period of strain, or even a period of austerity. These difficulties may be mitigated by foreign assistance, but they cannot be wholly eliminated; however, once confidence has been restored, the basis is laid for more solid progress to the advantage
of all sectors in the population. In varying degrees, all countries have to accept some inconveniences and sacrifices to gain the very real advantage of a good currency, and in the midst of conflicting interests it is often difficult to decide what are the proper lines of policy. Serious thought is being given to these questions, and it is impossible not to be impressed by the knowledge and wisdom, the courage and determination, with which the central banks and other monetary authorities throughout the world devote themselves to their difficult tasks, and by the change in public opinion which has made it possible for the authorities in a growing number of countries to pursue effective credit and fiscal policies.
Annual Report, 1959 *

The enlargement of the Fund's resources, which was proposed last year in New Delhi, became effective two weeks ago when coun-
tries having over 75 per cent of total quotas had consented to the
increases in their quotas. As a result of further consents received
since then, I am glad to announce that the proportion has now
reached the figure of 83.56 per cent of total quotas. . . .

As a result of these steps, the Fund's total resources are being
increased from the equivalent of about $9 billion to about $15
billion. Until very recently, the Fund's effective liquidity was gen-
erally judged by the relation between its holdings of gold and dollars
and the possible demands upon its resources. After the improve-
ments in the monetary field in the last few years, which were so
signally expressed by the concerted move to external convertibility
by so many countries at the end of last year, the effective liquidity
of the Fund has been substantially strengthened. While up to the
end of 1957 no less than 92 per cent of all drawings from the Fund
were made in U.S. dollars, about one quarter of all subsequent
drawings have been made in other currencies. With the establish-
ment of external convertibility, we may expect this trend toward a
wider use of currencies to be strengthened. Indeed, in one recent
substantial drawing, one half of the amount was drawn in sterling
and French francs.

However, the purpose of the increase in the Fund's quotas has
not been primarily to provide additional resources for current opera-
tions in the short run. There has been no evidence of any immediate
shortage of international liquidity; indeed, the recent strengthening
of monetary stability may even reduce demands on the Fund in the
period immediately ahead. The purpose of the increase was
rather to give members confidence that in the Fund they have an
effective second line of reserves—particularly in cases of emergency
when, in a relatively short period, there may be substantial calls
upon the Fund. . . .

* Statement presenting the Annual Report of the Executive Directors of
the Fund to the Board of Governors, Washington, D.C., September 28, 1959.
External Convertibility

The introduction of external convertibility may be regarded as the consummation of the first stage of a process extending over many years for strengthening the economic and financial position of countries all over the world. The monetary disturbances which were brought about by World War II could not be easily overcome; but through increases in national income and the more effective application of flexible fiscal and credit policies, the excessive liquidity which weighed on many economies in the postwar years has gradually been worked off, so that by now the authorities in many countries have got a firm grip on the monetary position. Though the time was undoubtedly ripe, and the circumstances propitious, for a concerted move to convertibility, the decisive steps themselves needed, as always, imagination and courage, and also a readiness to cooperate. The move can now be seen to have been fully justified by the quite remarkable rise in the monetary reserves of most of the countries concerned. In Western Europe, monetary confidence has been increasing conspicuously, not only as regards the external value of the currencies, reflected in the firmness of the exchange quotations, but also in regard to the internal value, for the good and simple reason that neither wholesale prices nor living costs have risen appreciably in most of these countries for a year or two.

The convertibility move has resulted in a greater freedom from exchange regulations, and it is important to remember that this means at the same time a reduction in costs. An interesting concrete example of such a reduction was recently given to me by a Swiss banker. He told me that any loss in profits from the reduced volume of exchange transactions resulting from a shift of exchange dealings to London had been more than compensated by the reduced costs of handling other foreign business (transfer of funds, cashing of coupons, etc.), made possible by the steady reduction of paper work involved in exchange controls. In a broader—and much more important—sense, the very fact that business firms can count on stable exchange relations over an increasingly wide field means that less provision on account of exchange risks has to be made in the prices charged for commodities and in the valuations placed on foreign investments. Wherever monetary uncertainty exists, businessmen are forced to spend a good part of their time in con-
sidering exchange questions—time which ought to be spent on their proper business of producing and selling their goods. Restoration of monetary confidence thus results in reduced costs—a reduction which in competitive markets will ultimately be passed on to consumers. In this and in other ways it will contribute to the expansion of world trade and, indeed, facilitate foreign investments. Let us not forget that the virtual stagnation of world trade in the 1930's was undoubtedly aggravated by the monetary uncertainty which was a feature of that decade. These are market developments, but they will tend to be reinforced by the changes in public policy which should follow from the move to external convertibility.

The European Payments Union, for eight and a half years up to the end of 1958, made a most useful contribution to progress in Europe by assuring prompt payments and by giving an impetus to the relaxation of trade restrictions. The participating countries extended credits to each other for part of the net payments due to them; consequently, they did not receive in gold or convertible currencies the full value of whatever balance of payments surplus they acquired inside the Union. They were, therefore, not able to apply the full value of surpluses within the Union to meet deficits with other areas; this was of particular importance in relation to the dollar area, and, indeed, was one of the reasons given for the retention of discrimination against dollar goods. But now that, in Europe and elsewhere, exchange receipts are, with relatively few exceptions, obtainable wholly in convertible currencies, this particular difficulty has disappeared.

Discrimination Now Unjustified

In matters of international trade, the distinction between "hard" and "soft" currency countries has really become an anachronism. The traditional argument for continued discrimination has thus, by and large, been eliminated.

There is, however, the further question whether a sudden elimination of discrimination would lead to such an increase in the imports of, say, dollar goods, that balance of payments equilibrium might be impaired. Fears of that kind are not really borne out by the experience of those European countries which have substantially reduced the degree of discrimination. But even suppose that there
should be a certain temporary increase in imports, it might well be asked whether such an increase could not be sustained by countries whose reserves in gold and convertible currencies are steadily increasing. And even for other countries, once their exchange receipts are largely in convertible currencies, the extension to their importers of the right to buy in the cheapest market can hardly be said to be likely to impair their balance of payments. The essence of the problem of the remaining discriminatory restrictions, which have modified the pattern of trade, is that they are now more clearly seen to be protectionist devices; and it is likely that for this reason there will be resistance to their removal. They thus become a problem of commercial policy and are no longer to be considered a balance of payments problem. The general trend of commercial policy has certainly a monetary significance; the maintenance of discrimination, moreover, undoubtedly acts as a strong irritant, liable to bedevil commercial relations; it may provoke a resurgence of protectionist sentiment, especially when the business trend turns downward; and if such possibilities are not guarded against, the result might well be a dangerous disruption of trade relations in general. The time has clearly come when, for many reasons, the practice of discrimination should be abandoned with the least possible delay. It is my personal conviction that for the vast majority of countries there are no longer any balance of payments reasons for the maintenance of discrimination.

So far I have referred to the particular problem of discrimination. With regard to the general level of restrictions, whether discriminatory or not, the Fund has certain duties in relation to the Contracting Parties to the General Agreement on Tariffs and Trade (GATT). The Fund has already had occasion to conclude that restrictions maintained by a member country were not justified on balance of payments grounds. In view of such a finding, the Contracting Parties have in turn applied their procedures in dealing with the quantitative restrictions maintained by the individual country concerned. The Fund has a role in making findings concerning these matters whether or not the country in question remains under the regime of Article XIV of the Fund Agreement.

*Article VIII and Article XIV*

This leads me to say a few words about another important question, namely, the problems arising in connection with the move of
countries from the status of Article XIV to that of Article VIII. When the Fund was set up, it was felt that a transitional period would be needed before the member countries gravely affected by the war would be able to implement the full obligations under the Fund Agreement. To that end the “transitional arrangements” under Article XIV were designed to give these member countries time to overcome their balance of payments difficulties before they were required to eliminate their existing exchange restrictions. Under this Article, many member countries have been free from any obligation to obtain the approval of the Fund for the maintenance and adaptation of their existing restrictions on payments and transfers for current international transactions. Instead, since 1952, these countries have had annual consultations with the Fund on the need for retaining those restrictions. In these consultations, which are commonly referred to as Article XIV Consultations, the continued need for remaining restrictions has been carefully scrutinized, and in addition much attention has been devoted to exploring ways and means of overcoming existing weaknesses and achieving external equilibrium.

Over the last few years, much progress has been made in the removal of restrictions; as this has continued, the scope for adapting restrictions under Article XIV has steadily diminished for a number of countries that have gradually reached a position where legally the reintroduction of restrictions (as distinct from the adaptation of existing restrictions) would require approval under Article VIII, even though the countries themselves remained formally under Article XIV.

The formal assumption of the full obligations of Article VIII would mean that such a country was willing to accept the requirements that it seek the approval of the Fund for any remaining exchange restrictions, and the prior approval of the Fund for the adaptation of any such restrictions or for the introduction of new restrictions, if this should ever become necessary.

Several times in the past the question of the relationship between Article VIII and Article XIV has been considered by the Fund, but so far immediate action has seemed premature. Now, with the adoption of external convertibility, a number of countries which have swept away most, if not all, of their payments restrictions will have seriously to consider, as a practical proposition, the question
of a formal transfer to Article VIII. Both the studies made in the past and the attention recently given to these problems in the Fund—and also in a number of member countries—have shown that several issues arise which need clarification, and it is important that before any definite action is taken the Fund and its members should have a clear idea of what is involved.

In any examination of this question it will be necessary to consider which members are in a position to assume the full obligations of Article VIII; what should be the procedure and rules for expressing the Fund's views on any remaining exchange restrictions, and on any request for the introduction of new exchange restrictions; how regular contact can best be maintained with countries which are under Article VIII and which, therefore, are not required to participate in the annual Article XIV Consultations. In addition, the change in status of a number of Fund member countries would bring into force the revised GATT provisions dealing with discrimination. These questions require careful examination in all their aspects and will be taken up by the Executive Directors in the very near future.

It is all to the good that the Fund should from time to time review its essential tasks and the most appropriate methods for its work, in the light of the changing circumstances under which it has to operate. Such a review may be particularly useful when it is combined with the search for practical solutions to current problems—in this case the change of status from Article XIV to Article VIII. As over the years to come more and more countries are able to conform to the full requirements of Article VIII, there is bound to be a shift in the main preoccupations of the Fund and in its daily work. There will still be a need for financial assistance even for countries under Article VIII, since difficulties, often of an unexpected nature, are likely to arise in the future, as in the past; but the day will come when fewer countries will turn to the Fund with requests for assistance in the elaboration and implementation of comprehensive stabilization programs. This is not to say that the Fund's work will then be made any easier—perhaps rather the contrary. In dealing with a stabilization program, it is usually not difficult to tell what measures need to be taken—balance the budget, restrain credit, and establish a realistic exchange rate. The difficulties usually arise when the program is put into effect. I am
often reminded of Napoleon's famous saying, *La stratégie économique est un art simple, tout d'exécution*. For the successful implementation of a stabilization program there are needed, above all, conviction, character, and courage.

When stabilization has been achieved by a considerable number of countries, the problems that arise—some old, some new—are likely to be intricate, as regards both economic diagnosis and the finding of proper remedies. How to mitigate booms and depressions; how best to combine economic expansion with reasonable stability; how to ensure proper debt management; how to alleviate, through timely foreign financing, the strain in the balance of payments of countries engaged in development; how to deal with the difficulties which arise when the prices of a country's main exports are declining—these are all matters which require great economic insight and awareness of political factors. These problems fall under Article I of the Fund Agreement, which affirms that the Fund, while promoting exchange stability, also has, among other things, "to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy." 1 These should not be empty words. Now that the transitional period after the war draws to its close, more attention should be paid to these general objectives of the Fund. Since the decisive measures are generally those taken by the authorities in the individual countries, such influence as the Fund can exert will largely depend on the confidence it is able to inspire as an expert body always ready to consider on their merits the problems that arise and to find solutions which are in the true interests of the member countries.

*Problems of Stabilization*

At this point I should like to make a few general observations on the problems which arise when efforts are made to restore balance in an overstrained economy. Whatever external resources are obtained, the implementation of a stabilization program designed to eliminate inflation will almost inevitably be followed

1 Article I (ii).
by a period in which certain hardships are experienced and the rate of economic expansion somewhat reduced. These difficulties should, however, be set against the background of the methods employed to sustain the preceding expansion, which, nourished by inflation, will often have been of a distorted character.

Among these methods I would mention, in the first place, the "forced savings" which usually become available for a time in the early stages of an inflationary period.

Temporary resources have also been obtained in the form of so-called "suppliers' credits" from abroad, maturing within three, five, or seven years. As the maturities fall due, however, the strain on the balance of payments and on the reserves has often been so acute that critical situations have arisen. There is a limit to the extent to which countries can borrow short and invest long, and this limit is soon reached. Moreover, when the limit is reached, exporters to such a country begin to demand prepayment. Thus a situation is created in which a country, itself very much in need of capital, not only obtains no further credit but may even be forced to extend what amounts to credit to traders in other countries.

A third method of obtaining temporary resources is to make use of monetary reserves. Several countries which, during World War II or the Korean crisis, accumulated larger reserves than they had before, embarked upon a policy of development by drawing down reserves—but there again they had to be careful not to push this policy so far that reserves became inadequate and monetary confidence was thereby impaired.

These three methods clearly do not provide a durable basis for sustained growth; and worse than that, reliance on them is bound sooner or later—and often sooner rather than later—to result in a monetary crisis. In recent years there have been many instances of such crises in both industrial and nonindustrial countries, in some cases aggravated by additional factors, such as an excess of liquidity inherited from the war, sometimes involving large claims in foreign hands. Whatever the cause of any particular crisis, there have generally been signs of inflationary tendencies, accompanied by falling reserves. Since a repetition of crises is an intolerable state of affairs, steps have to be taken before long to put a stop to an unbalanced position and to restore confidence. As a rule, these steps are taken with the immediate purpose of replenishing mone-
tary reserves, a process which requires part of the savings of the country concerned to be invested in additions to reserves—savings which cannot therefore, for the time being, be invested in bricks and mortar, machinery, or inventories at home. Any country pursuing such a policy has to pass through a phase of adjustment, during which economic expansion has, as a rule, to be slowed down. It is impossible to frame economic and monetary policies that are perfect in every respect all the time. An interval of adjustment, when required, serves its purpose by providing a firmer and more reliable basis for renewed growth. It has been the experience of several countries in Europe, as elsewhere, that once stabilization measures had become effective, a revival of activity set in. This is true of nonindustrial as well as industrial countries. After all, not all countries of Europe are highly industrialized. Finland, whose exports consist largely of forest products, has over the last year or two been cited as an example of a country in which a policy of ensuring monetary balance ushered in a period of economic stagnation. It is true that for a time industrial production declined, but not for long. The recovery has now more than made up for the decline in the period of adjustment, and in recent months industrial production in Finland has been running 10 per cent higher than in the same period last year.

Sometimes I am told that the expansion in some countries would not have been at the rate actually achieved had it not been for resort to credit expansion, which, though necessarily inflationary, had in fact helped to finance part of the investment. It is of course difficult to tell what would have happened under different circumstances, but I have often wondered whether progress would not, on the contrary, have been greater if more attention had been paid to monetary stability, with the added advantage that the progress would have been achieved under more satisfactory social conditions. After all, the great development of the U.S. economy from 1870 onward was not based on inflation, and the rate of expansion was in fact as high in the period of slightly falling prices up to 1900 as it was in the years of slightly rising prices that followed up to World War I.

**Difficulties of Primary Producers**

Over the last ten years, industrial production in the Western world has been expanding at a rate of almost 5 per cent per annum,
and the volume of imports of the industrialized countries by 6 per cent. On the other hand, the exports of the primary producing countries have risen in volume by only a little over 3 per cent per annum, and the real value of these exports—in terms of their power to purchase imports—by just over 2 per cent. In large measure, these developments have been the result of certain technical aspects of recent economic growth. Thus, in the highly industrialized countries, expansion of output has been heavily concentrated on more complicated manufactured goods, such as machinery, electrical goods, aircraft, etc., with a relatively low raw material content, which has limited the demand for raw materials.

The more effective use of materials, perhaps most strikingly illustrated by the tin-saving process of electrolytic plating, has had a similar effect. In addition, the substitution of synthetics for raw materials, which has been rapidly spreading in many of the major branches of manufacturing, has been of great importance—the use of plastics, detergents, synthetic fibers, and synthetic rubber, to mention just a few. The immediate impact of these changes is no doubt unfavorable to raw material exporters, at least during a transitional period, but they are part of the technological progress of our times.

Even so, these problems should not be approached in a spirit of gloom and fatalism. Wise policies can undoubtedly help to solve them. In the first place, it is the task of each primary producing country to see that its products are moving to the markets; so far as it is necessary to give support to producers, it is important that such support should not be financed in an inflationary way, for this would raise costs and make sales more difficult. Indeed, every effort should be made to introduce more effective methods of production, so as to render production more remunerative and so that the country in question does not lose ground to other producers but is able to retain its share of the market.

The more highly industrialized countries also have their contribution to make to the solution of this problem. They can do so, firstly, by helping to sustain demand for raw materials by maintaining their own economic progress. Generally speaking, demand has been well maintained in the postwar years; the cyclical recessions in this period have been mild compared with those of earlier
periods, even before 1914. In none of the years of recession in the United States, 1949, 1954, and 1958, was there any decline in the volume of primary producers' exports, and the purchasing power of these exports in terms of imports declined only in the most recent recession, though it flattened out somewhat in 1949. By now the Western European countries have, for the most part, passed through the recent phase of adjustment which, for a number of them, was necessary to enable them to regain monetary strength. In the future, they should be less affected by monetary problems; this is of importance when it is realized that the Western European countries as a group absorb more than half of the raw materials and foodstuffs exported by the underdeveloped countries. The recovery from the recession in the industrialized countries has already gone some way toward easing the difficulties of the primary producers. The increased demand for many of their products this year has made it possible for them to increase the volume of their exports; and in the last six months, the general level of primary product prices has shown some recovery.

Secondly, importance attaches to tariff policy and protection generally in the industrialized countries. Their food production, often highly protected, has risen despite a decline in the agricultural population. Here is a field in which these countries could make an effort to dismantle a number of protectionist measures that are clearly most harmful to the interests of the primary producing countries.

Some words should be added about possible discriminatory measures, which are of course always regarded as particularly unfair. When at the beginning of this year the six countries of the European Economic Community made their first reduction of tariffs, they extended this benefit in the main to all members of the GATT, and thus to all primary producers which are contracting parties to that Agreement. When the second year comes around, it may be possible to agree upon a similar arrangement, and, in view of recent developments, parallel action might well be taken by the new group of seven European countries. After all, Europe has benefited so much from the relatively low prices of primary products in the last three years that it might well extend some counterbenefits to the producers of these products.
Needs of Developing Countries

Many of the raw material producing countries are exporters of only one major commodity, and for them in particular a solution must be sought in the diversification of their economies, not least in order to develop additional lines of exports. Diversification, however, requires, as a rule, capital resources beyond what these countries can raise in the form of savings from their own, often low, incomes.

Countries engaged in development have therefore sought in the past, and will seek in the future, to avail themselves of foreign resources to supplement their own savings. The use of such resources enables them to increase their imports, and thus will tend to produce a current account deficit in their balance of payments, which is to be expected in such circumstances. The question of proper timing of investments in relation to the receipt of foreign resources is then of particularly great importance. If, for instance, large investments which are not matched by sufficient domestic savings are undertaken at a time when foreign resources are not available, and the attempt is made to obtain the funds required by expanding credit, the effect will generally be a combination of internal inflation, import restrictions, and a decline of monetary reserves. Even if the requisite foreign resources become available at a later date, it is not always easy to reverse the primary inflationary impact and to replenish the reserves. If monetary stability is not to be endangered, it is therefore important that investment expenditures, for which domestic savings are not sufficient, should be supported in good time by foreign capital. The coordination of the flow of capital and the rate of development expenditure is a task important both for the developing countries themselves and for the countries that supply the external resources. The problems of development require a balance of responsibilities between those who provide and those who receive capital. All partners are equally concerned with the continued creditworthiness of the developing countries. Official sources cannot be expected to furnish all the capital needed, and substantial amounts of private capital must also be attracted to the underdeveloped countries; creditworthiness is important for both types of capital but is, of course, a matter of prime importance where private capital is concerned; and in judging creditworthiness, monetary stability is a most important crite-
rion. Both the countries supplying and the countries receiving capital have everything to gain if they can avoid narrow nationalism, for these are not purely financial problems—it is in the interest of both parties to see that the technical methods employed are likely to produce the best results from the investments which are made. As attention to monetary stability must be the concern of the receiving countries, so the resources provided by the supplying countries, which have now increased in number, will be more effectively employed to the extent that the receiving countries are allowed to buy in the cheapest markets.

Since the monetary situation is influenced by the methods employed to finance development expenditures, the Fund has an interest in these matters, even though its own financial assistance is restricted to short-term balance of payments purposes, drawings on the Fund being repayable not later than three to five years after the drawing. I may recall in this connection that resources made available by other institutions to support stabilization programs arranged with the Fund have sometimes been of a long-term character. I must also point out that one of the purposes of such stabilization programs is to improve the creditworthiness of the countries concerned in order to give them a surer basis for their long-term development.

I cannot leave this subject without also referring to the commodity agreements which have attempted to regulate the supply and prices of particular commodities. Even the most effective of these agreements can only be said to have been moderately successful. Indeed, those commodities with regard to which market forces have been allowed to have their influence most freely seem often to have fared better over a period of years. When considerable stocks have been accumulated, nationally or internationally, difficulties are bound to arise, however much those in charge seek to avoid disturbing the markets or impairing the interests of other countries’ producers.

We have seen that there is no single cause for the problems of the primary producing countries, and neither can we say that there is one single remedy. Progress must be sought along different lines: in some fields, action is required by the primary producers themselves; in others, the active support of the industrial countries is needed. If this varied approach is followed, there is every prospect
of an improvement in the general situation. In these efforts, international institutions have a role to play. Among the primary producing countries affected by temporary difficulties, some have turned, and will in the future turn, to the Fund with requests for assistance, sometimes of a seasonal character, sometimes for the elaboration and implementation of stabilization programs. The dimensions of the problem are now more clearly known, and the difficulties appreciated. Much remains to be done, but, with good will and appropriate policies on all sides, these problems can, I am sure, be solved.

Prospects of Stability

Monetary stability has indeed become a guiding principle for the vast majority of countries. In all likelihood, world inflation is over. Now that the excessive liquidity inherited from the war has been worked off, credit policies have become more effective. Output has risen, competition is fiercer, and the resistance to cost and price increases has grown in strength. If we look back at past periods of economic history, we find that a persistent decline in raw material prices has more than once been an indication of the cessation of general price increases. Since more and more currencies have become convertible, and since supplies of goods are readily available in most lines from a variety of sources, no individual country can—without grave risks—afford to deviate from the international price trends. Naturally, countries must seek to avoid these risks; and when they make more and more efforts to balance their budgets or, at least, to reduce their fiscal deficits, many of them do so not only as part of an anticyclical policy, but also for balance of payments reasons. The present expansion needs to be carefully watched, for we have to remember that a pronounced investment boom, if one develops, would involve not only progress but also strain, and could have dangerous consequences if it were allowed to get out of hand.

The meeting of the Fund two years ago here in Washington was held at a time of acute tension in the field of foreign exchanges, characterized by rather strong movements of funds, flowing especially to two countries, the Federal Republic of Germany and the United States. Germany has continued to have a fairly substantial current account surplus in its balance of payments, but thanks to
considerable capital exports (including debt repayments), the foreign assets of the banking system have been rising at a much slower pace. Developments in the U.S. balance of payments have also shown capital exports continuing high; however, the current account surplus began to decline at the end of 1957, and a deficit emerged in the first half of 1959. The over-all effect of these developments has been an outflow of gold from the United States and an accumulation of dollar assets in the hands of other countries. To some extent, this change has reflected the increased strength of producers in other countries who are now able to deliver more promptly a greater range of goods at competitive prices. It has also been connected with internal developments in 1958-59, when there was a sharp increase in the U.S. budget deficit and a substantial degree of credit expansion. These developments helped to overcome the recession, but the consequent increase in liquidity has, even in such a large country as the United States, affected the balance of payments position. The measures adopted to remedy the situation have been on the same lines as those which would have been taken in a similar situation in other countries—balancing the budget and restricting credit, while at the same time paying greater attention to costs. These actions serve as a clear demonstration that inflationary tendencies are being withstood, and their effects should naturally extend to the balance of payments. It is perhaps pertinent to recall that increases in interest rates, made in response to a strong demand for funds actively employed in business, do not arrest economic progress, but rather have the merit of ensuring a more balanced growth. They have, further, the advantage that a subsequent downward adjustment of the rates can be made effective fairly rapidly to provide an active stimulus to recovery if a change in the business trend requires it. Stiffer monetary policies are, of course, not intended to initiate a period of deflation, but represent simply an adjustment to a particular phase of the business cycle. By avoiding the twin dangers of inflation and deflation, the basis should be laid for a vigorous expansion in production and trade.

Over the last two years, we have seen a shift in emphasis in the relations between the United States and other countries, the move to external convertibility at the end of last year and other steps toward greater freedom in trade and payments, a generally lower level of prices for primary products, and a widespread slackening
of inflationary pressures. All these developments have created a new situation which has revealed the need for a fresh examination of many problems, both domestic and international. The Fund has felt the impact of these changes. As a relatively young institution, it has been faced again and again with fresh problems; and it has had to solve, and will have to solve, such problems as they come along—*solvitur ambulando*, as the Latin tag goes. Gradually, however, general principles have emerged; in their Annual Reports and in specific statements, the Executive Directors have from time to time explained the principles and policies which govern their decisions.

For the future, it is an important fact that the Fund now has at its disposal sufficient resources to meet the demands that may be made upon it, even in emergencies; this has given members confidence that they can move toward greater freedom of trade and payments without having to pay undue regard to temporary balance of payments difficulties. Indeed, the proposal to increase the Fund’s resources itself cast a shadow before it, since it was certainly one of the considerations which prompted some European governments to make the move to external convertibility at the end of last year.

Events have been moving faster than men’s minds. Recent improvements have implications for policy which have not yet been fully grasped. The time has now come for member countries to make full use of the opportunities opened up by the renewed increase in production and the general strengthening of the international financial structure.
The Economic Position of Europe *

A great war means destruction and disorganization, with a loss of manpower and a reduction of reserves. For Europe, this last war was followed by the loss of colonies and other dependencies overseas. For a time the picture was very black indeed—but thanks to Europe's own efforts, greatly helped by Marshall aid, which fructified the barren soil like a warm rain in the springtime, recovery set in, and after many a crisis a situation has been reached in which the European countries have attained an economic position which in all essential respects can be said to be better than at any time before in Europe's history. The Conservative Party in England fought the General Election last October with the slogan "You Never Had It Better," and that is I think true for Europe as a whole.

(a) Industrial production of the nineteen countries which are members of the Organization for European Economic Cooperation (OEEC) is now 80 per cent larger than before the war.

(b) The agricultural output is, on average, about 25 per cent above the prewar level—in some countries the increase is as high as 50 per cent. This increase has been due to the use of modern methods of cultivation and breeding, for it has gone together with a decline in the agricultural population. In food, Europe is more self-supporting than it has been for a very long time.

(c) Recently the monetary position has also greatly improved. I need only mention the establishment of external convertibility of most European currencies at the end of last year. This step was taken with some hesitation at the time, but subsequent developments have shown that it was the right decision. The combined monetary reserves of the OEEC countries are more than twice as large as they were at the end of 1948, and in real terms as high as at the end of 1937.

But I will not dwell on these aspects; for a visitor to Europe is aware of the improvements that have taken place over recent years. There are, of course, still some weak spots where the position has not yet been consolidated—Greece and Turkey are examples—but even in these countries, and also in Spain, substantial improvements are already visible.

What I want to do here today is to mention certain tasks which the European countries must attend to.

**Appropriate Domestic Policies**

In the first place, they have to see to it that the improvements achieved so far will not be jeopardized by unwise or reckless policies.

At the moment, business is booming in Europe, most markedly in the Federal Republic of Germany, but in many of the other countries as well. There is always the danger that the boom will get out of hand; that growing demand will dangerously increase prices and costs—including wage costs; that speculative excesses will occur; and that much business will be started which before long will be found to be unsound. If such trends are allowed to go unchecked, the ground may be laid for a crisis at a later date.

Fortunately, measures are being taken to moderate the boom. I have just visited Germany, France, and England, and may perhaps say something about these three countries in particular.

In Germany, the official discount rate has been increased from 2 3/4 per cent in August to 4 per cent, and the German Government is now borrowing genuine savings at an effective rate of slightly over 6 per cent. The central bank has recently asked the Government to take steps to carry out a policy of budgetary balance.

In France, a cautious financial policy is being pursued; the budget deficit is being kept within the limits laid down in the Stabilization Plan; long-term interest rates have declined from the high level of nearly 8 per cent to less than 6 per cent by gradual steps, but the monetary authorities have not intervened to lower the rate artificially by open market operations. This cautious internal policy has been a factor in the achievement of an export surplus, together with a substantial over-all surplus in the balance of payments which is almost without precedent in French history.
In Great Britain, industrial production has shown a welcome expansion in recent months, and is now running some 8 to 9 per cent above the level of last year. There has been a marked increase in productivity, and also in profits. So far, interest rates have remained practically unchanged for over a year; but the budget deficit is expected to be smaller than had been estimated; and now the work on the new budget has begun under conditions which will very likely require the pursuit of a more cautious financial policy than was appropriate a year ago when a stimulus was needed.

It will be remembered that during the crisis of 1957, the discount rate of the Bank of England was raised to the high level of 7 per cent. It has sometimes been thought that so large an increase would prove politically dangerous—that any government which dared to do such a thing would very likely be defeated in the next election. Experience has shown, however, that it is politically much less dangerous to do the right thing than is often thought, since the Conservatives won the election. In that election hardly any reference was made to interest rate policy. It seems that the public wants strong leadership—it wants a government that has the courage to do what is required to maintain the value of the country's currency, to stave off the renewal of a critical situation, and thus to restore confidence in the country's future in the widest sense. This need is felt particularly in Europe, for in that part of the world, after the inflation that has taken place and the series of exchange crises to which countries have been subject, monetary confidence cannot yet be said to have been firmly established. Confidence is a plant of slow growth; fortunately, Europeans know it. My belief is that they will take the necessary measures to safeguard their monetary positions. European currencies are, and will remain, safe.

**International Relations**

In the second place, the European countries must be careful about their relations with the outside world. To be prosperous, Europe can never be sufficient unto itself. It must trade with the outside world, and this aspect of Europe's position has always been important. It has become a more burning question recently because of the formation of two blocs by the six Common Market countries and the seven members of the European Free Trade Association. "The Six," as you know, have agreed to establish a common
market—with a common tariff. “The Seven,” on the other hand, will establish a “free trade area”—without the common tariff. In both cases, there should be free trade inside the group, while tariffs are planned to be maintained in relation to outside countries.

Other nations are, of course, anxious to know how all this will work out—and to tell you the truth, so are the Europeans! Because much of this is still in the early stages of development, there is fortunately scope for modification. There were originally two reasons for the formation of “The Six”—the Common Market Group: (1) In the countries on the continent of Europe which had suffered much during the war within their own borders and by losing colonies or other dependencies—or, as the Federal Republic of Germany, by losing a part of its own territory—the public was not unnaturally in a pessimistic mood for some time. There were many who thought that the only chance for these countries would be to join together to form an extensive home market, suitable for large-scale production, so that one day these countries would be able to compete more effectively with the United States and with Russia, which are big markets in themselves. Young people did not like to be confined to their own small areas, but wanted to have a wider field in which they could find useful employment and promotion; (2) The other reason was more distinctly political—it was felt that the age-long enmity between France and Germany should be relegated to the past, and there was every reason to try to tie Germany firmly to the West through partnership in common institutions.

Thanks to the improvements that have occurred, the people in Europe are certainly less pessimistic today, and though they still, in general, appreciate the advantages of a large market, they cannot help being impressed by the fact that the individual countries have already been able to recover without the help of such a market. The need for close political ties is certainly felt strongly in wide circles, but there is more awareness of the obstacles and difficulties to be faced in attaining the objective of a political integration. Some of the other countries in Europe—Great Britain, the Scandinavian countries, Switzerland, Austria, and Portugal—find it too much against their traditions to accept a high degree of political integration. But they, too, have felt the need for cooperation, and in order to strengthen their negotiating position and to widen their own markets, they have formed their own free trade area.
It has proved difficult to bring these two groups together by direct negotiation. I do not even think that it would be advisable for that to happen, for then only internal European interests would be considered. Europe must always remain extrovert, and always pay great attention to its relations with the outside world, with the United States and Canada, and with all the underdeveloped countries.

It is rather curious that the balance of payments difficulties experienced here in the United States have had an influence on these developments by making it clear to the European countries that they have in these, as in other, matters to take into consideration the interests of the outside world.

It is, as you know, the policy of the U.S. Government to maintain the present value of the dollar, and to continue to promote the growth of world trade. This means that the Government here will continue to resist protectionist pressures. The European countries have every reason to support these policies, since they, too, are greatly interested in the continued expansion of world trade. Europeans do not think that the dollar will be devalued; but they are particularly afraid of a growth of protectionist tendencies in the United States. They are afraid of it for economic and political reasons, for they hold that increased protection here will endanger the cohesion of the Western world.

They have noticed that certain American labor leaders have recently begun to demand increased tariffs. While business is good, industrialists have much less need to make similar demands—but what will happen if business again turns downwards, say, in two years' time? The Europeans must be careful not to take any action that might foster protectionist tendencies in the United States. What should they then do?

In the first place, they should remove the remaining discriminations against dollar goods. Much has been done in this respect already, and I feel sure that further steps will be taken in the same direction in the near future by a number of European countries.

In the second place, they should be careful not to introduce any new forms of discrimination, and here the policies to be pursued by both "The Six" and "The Seven" are particularly important. For this means that such tariff reductions as are agreed upon should be extended to all GATT countries, and thus include the United States.
In the third place, they should seek to avoid any immediate increase in the duties on raw materials and foodstuffs, for that would harm the underdeveloped countries. It is important to help these countries by financial assistance, but it is even more important to help them to maintain their own earning potential.

Fourthly, there are certain measures that may suitably be taken in the financial field. Some of the European countries have taken steps to repay dollar debts in advance, and I think others will soon do the same. The European countries should also take steps to share more fully in granting financial assistance to the underdeveloped countries.

To do this they must ensure that their own institutions for the extension of such assistance are provided with adequate resources, and are able to act somewhat in the same way as the ICA or the Development Loan Fund here in this country.

They must also devise some suitable means of coordinating this assistance so that a balance of responsibilities can be established to ensure that the proper steps are taken, both by the countries that grant the assistance and by those that receive it. Only in that way can the most effective use be made of the funds that are made available.

These are all measures that are within the realm of practical possibilities. I am sure that Mr. Dillon during his recent visit to several European countries has discussed these questions. I hope that a suitable forum will be found for further discussions, and that they will take place between the European countries in conjunction with the United States and other interested countries. Many problems will have to be solved, and that cannot be done in one spectacular meeting, but only through intensive discussions over a period of time which, however, should not be too protracted.

We have now reached a critical phase in world economic developments. There are strong forces working in favor of a continuing liberalization of trade, but there are also protectionist pressures. It is very important that the right road should be chosen. So much has happened in the last two years; there have been such great changes in the American and European positions that we have every reason to reconsider our various practices and policies and make a great effort to promote the continued expansion of world trade by concerted action.
The Role of the International Monetary Fund in Connection with Development

A. Background Paper *

The purposes of the International Monetary Fund are set out in Article I of its Articles of Agreement. In connection with development, Article I has this to say:

To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

The manner in which the Fund contributes to the economic development of the less developed countries is not by making development capital available. Under the established principles of the Fund, its resources are available for from three to five years to assist countries in temporary balance of payments difficulties, with the primary objective of gaining time for the countries concerned to take effective corrective measures. The Fund's contribution to development is, therefore, an indirect one; it is however no less important for that reason.

Monetary Stability and Resources for Development

The Fund has now had nearly fifteen years of experience in working closely with its member countries on their monetary problems. By far the larger part of its consultative work has been with the less developed countries. From this extensive experience one conclusion is becoming increasingly more evident, both to the countries concerned and to the Fund. That conclusion is that monetary stability is an essential condition, and indeed the only reliable basis, for sustained growth. Monetary stability increases the resources that can be made available for development in two

* Background paper circulated at the meeting of the OEEC Development Assistance Group, Washington, D.C., March 9, 1960.

1 Article I (ii).
ways. In the first place, it increases the long-term flow of genuine
domestic savings. In the second place, it stimulates the inflow of
capital from abroad, as countries, by demonstrating their ability
to run their domestic financial affairs competently, appear more
creditworthy to foreign sources of capital.

At least as important is the fact that monetary stability creates a
climate for the proper allocation of resources saved in the economy
or contributed by foreign capital. In the absence of monetary
stability, i.e., in conditions of inflation, investment tends to be
directed toward objects that are considered the best short-run
hedges against inflation, rather than toward those that will make
the greatest contribution to the economy in the long run. Stability
is necessary to translate the available savings into the kinds of
investment that will contribute to the balanced development of
the economy. As far as aid from abroad is concerned, it is there­
fore equally in the interest of the countries receiving the aid and
of those that provide it that monetary stability should be attained
and preserved.

Given the scarcity of development capital in less developed
countries, there is always a tendency to look to the banks—both
the central bank and the commercial banks—as a convenient
additional source of capital. But it is obviously absurd to believe
that the banking system can create out of nothing the real resources
needed for development. All that the banking system can itself do
is to create money, not goods. Within the framework of monetary
stability, the banking system can increase its total assets only slowly
as the needs for currency and deposits rise with the growth of the
economy. These annual increases in the resources of the banking
system are, broadly speaking, needed to provide the requirements
for circulating capital—such as inventories and work in progress—
and to increase gradually the country's foreign exchange reserves.
The banking system will thus normally not have any significant
resources available to sink into development projects.

If the banking system creates more money than is needed by
the growth of the economy at stable prices, the first result will be
a reduction in the country's foreign exchange reserves. The reduc­
tion in these reserves that most countries can stand is very limited,
so that no continuing contribution to development can be achieved
in this way. Excessive credit creation beyond this point will lead
to price increases and the depreciation of the currency. In some of the more developed countries, inflation has been known to make resources available for investment through what is called “forced savings.” This was brought about as rising prices reduced the purchasing power of wage earners and the middle class. Even in developed countries, this process would, however, soon get out of hand and cease to have any usefulness as workers began to insist on quick adjustment of their wages to the rising prices, and people generally reduced to a minimum the proportion of their assets kept in the form of ready money. In the less developed countries, where there are no large groups of people with fixed incomes, no lasting contribution to investment can be achieved by means of inflation, even if a country were willing to tread this path.

The fact that an increasing number of countries have over the last few years sought the Fund’s assistance in working out stabilization programs testifies to the widespread conviction that inflation, resulting in monetary instability, is a policy that on balance clearly has an unfavorable effect on development. By the determined implementation of these stabilization plans the countries concerned are providing the sound basis for an effective development program.

Fund’s Role in Connection with Temporary Balance of Payments Difficulties

While underdeveloped countries seek to devote a good deal of their resources and attention to the problems of long-run economic development, they are at the same time subject to many temporary difficulties, which often tend to work themselves out as balance of payments problems. Sudden fluctuations in the volume of production of their main crops or fluctuations in the world market prices for their main exports, as well as irregularities in the rate of supply of capital from abroad or in the rate of expenditure of all kinds—especially on development projects: all these and other factors will at times produce pressures on the balance of payments.

If these pressures are not handled properly, the country will not only experience a serious loss of reserves but may also have to impose import or exchange restrictions; its hard-won monetary stability may be jeopardized, with a consequent setback to develop-
ment. In a situation of this sort, the Fund has a double role to play. It will consult with the member on the financial and other policies that may be needed to see the country through its temporary difficulties; and it stands ready to make its resources available to the country while the corrective measures take effect, in order to soften the impact of the unfavorable developments. In doing so the Fund acts in accordance with the provision in its Articles which states as one of the purposes of the Fund:

To give confidence to members by making the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.2

The principles governing the use of the Fund's resources are now well established. . . . By the close link that the application of these principles and practices establishes between the Fund's financial assistance and the maintenance or adoption of the necessary remedial measures in the countries concerned, the Fund supports the observance of that degree of financial self-discipline without which the international monetary system cannot function properly.

The Fund's resources made available in such a situation are repayable over a period not longer than three to five years. Seen in the long run, therefore, the Fund's contribution does not consist in making available a net supply of capital, but in helping the country through a particularly difficult phase of its development, thus safeguarding the progress already made and establishing the basis for further future development.

Conclusion

In connection with the efforts that are being made to increase the flow of development capital from the main creditor countries to the less developed areas, it follows that the activities of the Fund are useful in particular in two respects:

(a) By the regular contact of the Fund with its members—through consultations and in other ways—the chances are increased that development plans and policies will be worked out within

2 Article I (v).
the framework of financial stability, and thus under noninflationary conditions.

(b) Access to the Fund’s resources, under the principles and policies worked out for their use, is likely to increase the chances that temporary difficulties encountered in the course of development can be surmounted without harm to the economic structure of the country itself or its trading partners.

B. Address *

At the risk of telling you what you already know, I will remind you that the Fund was set up at the end of the war to deal with monetary problems. The attempt to restore the gold standard after World War I had broken down; and the monetary conditions in the 1930's were to nobody's liking; so the idea arose to establish something new in the monetary sphere with the Fund as a center of cooperation.

The terminology of the Fund's Articles of Agreement tends to reflect the practices of intergovernmental financing used in the years just before and during World War II, and the specialized language found in these Articles therefore differs somewhat from ordinary market usage. But this should not obscure the nature of the financial operations of the Fund, which amount to the giving of credits and their repayment. These credits are given, not for any particular project, but for general balance of payments purposes of a temporary character, and are repayable in not more than three to five years.

Powers of the Fund

The purpose of the Fund is to help to establish a stable and smoothly functioning monetary system in the world. The Fund attempts this in three main ways:

(1) It grants financial assistance of the kind I have just indicated from its resources—and these resources are now after the recent increase quite substantial, amounting to a total of $14 billion in gold and members' currencies. In terms of gold and externally

convertible currencies, the Fund has $11\frac{1}{2}$ billion, of which $3$ billion is in gold. Applying a stricter test of currencies likely to be used by the Fund in its operations, the Fund holds in gold and such currencies an amount of something like $10$ billion. Since credits granted by the Fund are repayable, as I have just said, within three to five years, this is a revolving fund—and I am glad to be able to say that in the years which have passed repayments have been made in conformity with our rules.

(2) The Fund has certain legal powers with regard to par values, exchange restrictions, discrimination, multiple currency practices, and, indeed, to the convertibility of currencies. The Fund administers the rules in relation to these and other matters; and on the basis of these rules it establishes policies affecting the member countries. A recent example of this is the Fund's statement on discrimination, in which the Fund declared that there was no longer any balance of payments justification for discrimination by member countries whose current receipts were largely in externally convertible currencies.

(3) Powers are all very well, but influence counts for more—and the methods by which influence is exerted will become more apparent when I comment on the third main field of the Fund's work: its regular contact with the member countries.

This contact has over recent years been maintained most effectively by means of the annual Article XIV consultations of the Fund. After its first five years the Fund was required to enter into annual consultation with countries maintaining certain exchange practices impeding a free trade and payments system, in order to consider with the member countries whether these practices should be retained or eliminated. Such consultations have been held regularly with fifty-six member countries. At the beginning, member countries regarded these consultations with a certain amount of concern—in some cases almost suspicion—but all this has changed. In this field there has been a very interesting development of Fund activities—and this has also affected the nature of the consultations. It soon became clear that a restrictive system could only be properly understood against the background of the general economic and financial position of the countries concerned, and attention has been increasingly devoted to these basic conditions. As restrictions have gradually been reduced, the emphasis in the consulta-
tions has shifted decisively to a review of the general economic and
financial situation. This change in emphasis has met with the ready
acceptance of member countries, because they have come to look
upon them as useful from their point of view; at the same time, the
consultations have certainly been useful for the Fund.

Value of Fund Consultations

How have they been useful? In the first place, the countries have
found that an annual review of their situation, together with impar-
tial outside observers who have a great deal of experience in the
affairs of many countries, gives them a better grasp of their own
problems. I have been told in more than one country that the
annual consultation with the Fund provides an occasion when
representatives of various departments have to get together and
coordinate their views on their own country’s problems—and we
all know how important it is to get from time to time a comprehen-
sive examination of a country’s problems. It is, for instance, very
useful that specialists in development become aware of the general
financial and trade problems facing their country.

Secondly, for the Fund, these consultations have been a most
useful procedure for getting acquainted with the particular prob-
lems of the members and with the officials who have to tackle these
problems. This has enabled the Fund again and again to act
promptly and effectively when members have submitted requests
for financial assistance, and action on other proposals such as par
values or rates of exchange.

May I at this moment add some further, perhaps more personal,
views?

The last few years have seen the emergence of many newly
independent countries, and this process continues. They belong
by and large to the Western free market system, which is not an
easy system to hold together. These countries cannot be expected
to be fully experienced in the principles of this system; and they
may easily make mistakes that could be avoided. Through the
consultations, the Fund is able to contribute experience and advice
with a minimum of publicity—and I would like to emphasize
how valuable this can be from many points of view, as we have
seen in not a few individual cases. Membership in the Fund is a
kind of partnership, through which the members are assured that nothing can be done or said without their knowledge, and in which they have the right to make their views known and to have them considered.

Let me now look upon this system of consultations from the point of view of the countries extending assistance to underdeveloped countries. If these underdeveloped countries pursue inflationary policies, assistance received will be largely dissipated. People will then hedge against inflation, and disregard what best contributes to the economy in the long run. The countries will, moreover, be considered less creditworthy, and therefore receive less private capital to supplement official financing. Insofar as the Fund can help to keep the underdeveloped countries on the right road, it renders a service of importance to those creditor countries which provide assistance. The taxpayers in the creditor countries may, indeed, have good reasons to be grateful for the efforts thus made to ensure monetary stability!

It is very important, I think, that the Fund's consultations with member countries, as they have developed, should be continued. I do not think that will be possible if the industrialized countries themselves do not engage in similar consultations with the Fund on their own positions. The new countries have a high degree of *amour propre*: they will accept what others accept— but no more . . .

Before I turn to the other tasks of the Fund—and I think I have probably said enough here today about the legal powers and rules—I would like to add one thought. The rules are intended to secure fair treatment for, and among, member countries. As rules of law, they provide particular protection for the weaker members of the international community—and these are generally the underdeveloped countries.

*Financial Assistance*

I now come to the financial assistance extended by the Fund. . . .

It was not an easy matter for the Fund to arrive at generally accepted principles governing the use of its resources. It took quite some time, but the stage was set when it became necessary for the Fund to become active on a substantial scale. These principles
have been submitted to a severe test in the recent busy years of Fund work, and they have been found eminently practical.

Each member of the Fund has a quota which determines in several respects its rights and obligations in the Fund. The extent to which a member may use the Fund's resources is related to its quota. The Fund's expectation with respect to members' policies increases in proportion to the amount of assistance, in terms of its quota, that a member seeks from the Fund. To put it in other words: the greater the assistance requested, the more sure the Fund needs to be that the policies followed are the right ones.

I do not say that we have always been successful at the first attempt, but at the moment it looks as if progress were being made over a broad front. We are helped by the fact that people all over the world seem to be getting tired of inflation and want to know what their money is worth. This applies not only to industrialized but also to less industrialized countries.

Underdeveloped countries have thus needed Fund assistance in relation to stabilization programs, but they are likely to need such assistance in other circumstances as well. In addition to their long-term problems, they may be subject to many temporary difficulties, which work themselves out as balance of payments problems. Such difficulties may arise from bad crops, a sudden drop in export prices, irregularity in the supply of capital from abroad, and also unwise policies at home. When such factors produce pressures in the balance of payments, an underdeveloped country—like other countries—can of course turn to the Fund. By timely assistance from the Fund and proper measures in the country itself, a serious deterioration may be avoided. Loss of reserves may be kept within tolerable limits; restrictions avoided that would be harmful to trade; and contractual commitments may continue to be serviced, so that the country can remain creditworthy. In this way, with stability maintained, the flow of development capital can continue to the benefit of both the givers and the receivers.

Conclusion

By what I have said I do not want to overstate the role the Fund can play. Stability is the result of many factors. It is particularly important that the earning position of primary producers should
not be impaired by tariff increases, or by violent fluctuations in business activity in the leading industrial countries, or difficulties created by sudden changes in the supply of development capital.

But I would like to emphasize that, in relation to the underdeveloped countries, the Fund is the only institution which specializes in the monetary field and which has adequate powers and resources assigned to it. And monetary policies will always affect the proper use of whatever development funds are made available. . . .
The Economic Function of Interest Rates in a Free Economy *

I shall speak today of the economic function of interest rates in a "free economy"—a free economy characterized by the free play of market prices, as it is in most of the countries of the Western world. I shall, however, have occasion more than once to mention the role played by interest rates in the economic life of the communist countries, which have established what may be called "centrally planned" economies, for in some ways the role played by interest rates in these economies is not so different from their role in our part of the world as is sometimes thought.

The so-called public sector—the part of the economy which is in the hands of the public authorities, through the operation of the budget or in other ways—has grown in importance over recent years, but, even so, the private sector comprises fully two thirds of the economy—generally even more—in most countries of the Western world. The activities of the private sector are determined by the price system, i.e., by prices resulting from market forces of supply and demand, by which the profitability of various activities is established and an impetus given to the production of more of those commodities the demand for which is rising and less of those for which demand is falling. In these circumstances, it is the consumer that determines what will be produced. The price system acts like an "invisible hand," as Adam Smith put it nearly two hundred years ago. For the freedom of the individual, this is clearly preferable to the heavy hand of governmental direction. We all know that the adjustments required in a free economy are not always easy and agreeable, but they are made, and a certain evening-out in earnings is achieved by the fact that capital and labor is transferred to the more profitable lines of business and production. It is in this way that great economic progress and the improvement in the general standard of living has been achieved over the last two centuries since the Industrial Revolution—which

*Speech before the Association of Reserve City Bankers, Phoenix, Arizona, April 4, 1960.
began about the time when Adam Smith wrote his *Wealth of Nations*, published in 1776, and when the American Colonies declared their independence of the British Crown.

In the communist countries, although they have centrally planned economies, it seems that prices are now allowed to play a somewhat increasing role; but the main decisions about investment and marketing are still taken by the authorities. The working of these economies is in some respects akin to what we ourselves experienced during the war, when it was vital, as quickly as possible, to obtain an increase in the output of armaments and other things needed in the war effort—which would have been impossible, and even inordinately expensive, under the somewhat slower adjustments produced by the operation of the price system.

It has been interesting to observe how keenly the leaders in the communist countries have wanted to industrialize at a rapid rate. They have felt that industrial development was the sign of an up-to-date country, and thus a respected country. For that reason these leaders were determined to use methods of compulsion and direction, both to start industries and to obtain the large amounts of savings needed for industrialization. Consumption had to be kept down; communist leaders knew that credit creation could not take the place of genuine savings. In the past, rulers in different parts of the world have again and again wanted to bring their countries up to the accepted standard of the time they lived in. In the early Middle Ages, to be a Catholic country was to be a "modern country." For instance, in my own country—Sweden—the kings, in order to speed up the acceptance of Christianity, arranged for "forced baptism." There is—however curious it may sound—an inner connection between the "forced baptism" of the early Middle Ages and the "forced savings" and other forced activities of communist countries, for in both these cases it was a question of becoming modernized and gaining self-respect—and doing it quickly.

But forced baptism hardly produces true religion, and forced industrialization does not really produce true economic greatness. Forced systems have their weaknesses and disadvantages. I have a Swedish friend who two years ago saw a great deal of Russian industry. He met a number of Russian industrialists, and was able to speak to them privately and confidentially. He found quite a
number who told him that there would be no real efficiency in Russian production, but intolerable delays in delivery and continuation of poor quality, until a measure of market competition had been re-established. Since the communist economies have no real markets for the pricing of their own output, they often use price catalogs from Western countries in their foreign trade, particularly for all kinds of machinery, and they do that even in their trade with each other. In truth, markets as we know them not only are more conducive to freedom, but also are likely over the years to be more effective—and more likely to lead to sustained economic progress.

A Biological Analogy

May I now present you with an analogy and refer to some fairly recent ideas in biology, which I think are today generally accepted by physiologists. It seems that in the human body there are several self-adjusting systems by which, in spite of external changes, stability is maintained; these are called "homeostatic systems." An example of such a system is the mechanism involved in keeping a man's body temperature fairly constant in spite of outside influences of hot and cold weather. Suppose the body temperature is raised; as everyone knows, the body perspires more; increased perspiration leads to increased loss of heat by evaporation, which helps to bring the temperature down to normal again. The opposite kind of response comes into play when the temperature falls below normal. I need hardly point out how similar this self-adjusting mechanism is to the operation of the free market system. Interestingly enough, I have found this comparison mentioned by physiologists, for instance, by Professor Garrett Hardin in his book *Nature and Man's Fate*, published in 1959. He says in that book that the "invisible hand," as explained by Adam Smith, is clearly a homeostatic device. Thus physiologists have found analogies in economics—but I have not as yet found economists referring to these biological ideas. I think economists should do so, for there are interesting conclusions to be derived from these analogies.

In the first place, I think we can be very happy both about the wisdom of the body—as it has been called—and the market price system, in that we have at our disposal in both these cases self-
adjusting mechanisms. The mechanism of the price system may in some respects be imperfect, but it is the result of an age-long process of trial and error, and as an English economist, Dr. Paish, has put it: it seems overwhelmingly probable that the work and thought devoted to reducing the remaining imperfections of the mechanism of the price system will be more rewarding than to try to rely on the infinitely clumsier mechanism of direct control, backed by threats of legal punishments.

In the second place, it is well to remember that in the regulation of body temperature, human beings do not rely only on the self-adjusting mechanism—they wear clothes, they build shelters, they drink more in hot weather to help perspiration. In a similar way, it is not possible in economics to leave everything to itself. The government must be responsible for providing law and order as the setting for economic activities. But the government is also responsible for the public sector—with the budget, the welfare state, and the other forms (sometimes too many) of government intervention. This is certainly not a system of laissez faire. I need hardly point out that a further important task of the authorities is to provide "good money" for purchases and sales, to enable the price mechanism to function adequately. "Money does not manage itself," as Walter Bagehot said in his famous book *Lombard Street*, first published in 1873.

In the third place, if we conclude that some government regulation is useful, and even indispensable, we must insist with equal force that government action must not be arbitrary; it must conform to the basic principles of the market system. As the philosopher, Francis Bacon, told us about the year 1600: "Nature can be commanded only by obeying her." We have therefore to know and understand the basic laws and principles of the price system in a free economy; and only if we act in conformity with those principles can we expect useful results from government action. Now we all know that government intervention is not always wise, and that therefore measures are quite often taken which even defeat themselves. I hope it is not indelicate in this connection for me to refer to the agricultural policies of the United States. I could easily cite examples from other countries as well, where the results have not been what had been expected because too little attention had been paid to the principles of a market economy.
Functions of the Rate of Interest

Here today we are especially concerned with "the function of interest rates in a free economy"—and we have therefore to consider how movements of interest rates can best be made to conform to the basic principles governing such an economy. The interest rate is of course, in the first place, a market phenomenon, and can as such be defined as the price paid for loanable funds of one kind or another.

These can be short-term funds or long-term funds—and the price, i.e., the rate of interest, varies according to the terms on which the funds are made available. I learned in the course of my studies of economics that there are different kinds of money—money in circulation, and savings of a variety of kinds, and "created credits" in various forms. But it was only when I went to the BIS in Basle, and took part in the management there, that I realized just how many different kinds of money (or funds) there are in the world. There is mortgage money and long-term money, money needed by the government, or flowing into industry; funds going into the stock market, money available for six months or three months, or day-to-day, and funds moving from one market to another internationally—each of these different kinds of money has its own character and generally its own price. We often speak of the rate of interest, but we really ought to think in terms of the interest rate structure which prevails at any given moment.

I may perhaps remind you that in the past, before the credit system was developed, the supply of funds was derived only from those who saved—mainly in the form of hard currency, of which there was an almost steady supply. Nowadays with the credit system it is possible to "create money." This is a power which opens up some useful and, indeed, indispensable possibilities, but at the same time it increases the opportunity for making grave mistakes. I think personally that some of the mistaken notions in this field arise from the fact that many people look upon the rate of interest simply as the price emerging from the balancing of supply of, and demand for, loanable funds, including funds supplied by banks, but forget the wider functions of the rate of interest.

For the rate of interest has indeed many functions to fill:

(a) I have mentioned the function of balancing the supply of and demand for loanable funds, with the need to take account of the variety of funds in the market;
(b) The supply of funds is closely connected with the creation of credit by the central bank and, with its aid, by the commercial banks;

(c) The rate of interest has an influence on investment, i.e., is a factor in the determination of what funds can profitably be employed in industry, commerce, and similar spheres;

(d) The rates of interest quoted in the markets have an influence on the flow of funds between countries;

(e) The inverse of the rate of interest is the capitalization factor, by which an influence is exerted on the valuation of capital assets;

(f) Rates of interest are an element in cost accounting, and have, as such, an influence on the relative price structure.

These functions in many respects go together, but a conflict may arise between the different influences, although perhaps less often than is sometimes assumed. And when there is a sudden increase in rates, what we may call "throwbacks" develop, necessitating adjustments of past evaluations—and these adjustments may be somewhat painful. It is always necessary—I repeat—to keep the various functions of the interest rate in mind, and this, I am afraid, is often neglected.

**Interest Rates and Prices**

Let me refer particularly to the role of the rate of interest as a factor in the determination of relative prices; as such, the rate becomes important for the direction of production, and serves particularly as a guide to what machinery can profitably be introduced as a substitute for labor at the ruling wage rates. The interest rate has to appear as an element in all cost accounting, since there is a cost element to be charged in proportion to the amount of capital employed. It is thus an element in the whole structure of prices and production. A notable thing is that the Russians have gradually found out that this function of the rate of interest also applies in their economy. At the beginning of the Soviet regime, the communists regarded the interest rate as just a matter of capitalistic exploitation, which was abominable to them; they therefore wanted to have no concern with it. But they have gradually found that their production and their price system would
be distorted if they did not allow for the cost of capital by including a charge for interest in the determination of costs and prices, and so on. There was an interesting article on this subject in *The New York Times* a few months ago, in which it was stated that Moscow had decided that an interest rate had to be charged in calculating costs and in planning production.

This function of the rate of interest is probably the most fundamental. It is because a profit is earned in production that interest rates can be paid. Production must not be taken in its narrow sense of only industrial and agricultural activities; housing is an important part, and much governmental outlay is for building purposes, though the test of profitability is in that context less evident. The demand for capital by industry, and for house construction, and by the government in its various forms, make up together almost the whole of the demand for long-term funds, and represent, moreover, the major part of the over-all demand for funds. If we take the statistics of "The Flow of Funds," as recently prepared by the Federal Reserve Board, we find that this flow was constituted predominantly, not by bank credit, but by credits based on savings, only in part handled by the commercial banks. In the United States the net increase in credit of all kinds came in 1959 to about $50 billion, of which $38 billion was for the purposes just mentioned, i.e., the requirements of the government (federal, state and local), mortgages (used mainly for construction), and the issue of corporate securities, while $6 billion (less than one eighth of the total) was for consumer financing, and $7 billion (less than one seventh of the total) was for what may be called "commercial financing" by banks. If we were to add self-financing by industry, we would find that the three main categories of demand for savings, the requirements of the government, the demand for mortgages, and industrial demand for new plant and equipment, represent together four fifths of the demand for capital.

**Demand for Long-Term Loans**

Let us now consider what determines the demand for long-term funds. Of the $50 billion net increase in credit in the United States in 1959, not less than $19 billion was for mortgages—thus largely for housing; $14 billion for government—largely roads, hospitals,
schools, and public utilities of various kinds. Clearly these needs are connected with an increase in population, and the fact that the population of the United States will continue to rise at a rate which over the next 40 years is estimated to be about 50 per cent higher than the rate of increase in Western Europe, will certainly contribute to a more brisk demand for capital here than in Western Europe over the years to come.

The influence exerted by an increase in population will affect both public and private demand for funds; more plant, equipment, and working capital will be needed to take care of the needs of a growing population—even without a rising standard of living. The demand for funds in industry, and in the public sector, will also be affected by the rate of technical progress. Past experience shows that in periods in which there were great technical inventions the demand for capital was particularly strong. One such period from 1900 up to World War I was ushered in at the end of the last century by the inventions that extended the commercial uses of electricity. This was a period of growing investment with rising interest rates. Another period of high demand for capital was the 1920's, when much investment went into the production of motor vehicles of all kinds with the development of the internal combustion engine. Interest rates were high, too.

From time to time pessimists have come forward and told us that there would be no further great inventions, and that therefore the demand for capital would slacken, interest rates fall, and conditions ensue which might well curtail the chances of continued economic growth. There were many pessimists in the years before 1900—and they proved wrong. In the 1930's Keynes was pessimistic. At the time he wrote the *General Theory*, he said to me in a private conversation (but he said the same thing to others, and traces of this are found in his published works) that now that we have had the great inventions of electricity and the internal combustion engine, he did not see that we could confidently expect any further important inventions requiring much capital.

How wrong he was, too! What a galaxy of inventions we have had in the last twenty years—and not only the big inventions, such as the jet engine, new chemical products, electronics, etc., but in all kinds of methods of production, requiring new layouts in almost all factories; and let us not forget the new methods that are being employed in agriculture, for they, too, are important.
When we then take into account that for many countries it is not so much a question of inventing new methods as of introducing methods already invented and employed here in the United States—and bearing in mind, in addition, the needs of the underdeveloped countries—it is no wonder that recently there has been a strong demand for capital, with a trend of rising interest rates. These rising interest rates, resulting from a strong demand for funds, are not a hindrance to growth but a reflection of growth—as pointed out in an interesting article on "Interest Rates, Cyclical Expansion and Economic Growth" in the Quarterly Review (for the fourth quarter of 1959) of Model, Roland & Stone, New York stockbrokers. As far as statistical evidence goes over the last 70 years, we are able to say that there has been a concurrence of rapid economic growth and rising interest rates. That being the case, there is no reason at all to expect a check to economic progress from the present level of long-term interest rates, insofar as that level is an indication of strong demand for funds for investment.

Supply of Capital

Now let me say a few words about the supply of capital. Experience has shown that in a free economy private savings add up to substantial amounts; in fact they may even be so large that Keynes at times wondered whether actual savings would not be excessively high, with the result that they would not all be invested without government intervention. (I keep referring to Keynes, for he has exerted so great an influence on modern economic thinking that his views cannot be ignored, whether we wholly like them or not.) Savings take many forms, such as plowing back profits, making mortgage payments, additions to pension funds, growth of savings accounts, private purchases of bonds, direct improvement to property by owners, and sometimes (though not often) government budget surpluses.

A question to consider is whether credit expansion can add to savings. The printing of paper money or the addition of some figures in a ledger obviously cannot be expected in themselves to produce any of the real resources that are needed for investment. But it is possible that an inflationary rise in prices, which acts in a way as a tax—a very unjust kind of tax on the holders of money and people with fixed incomes—may under certain circumstances bring
forth, for a time, real resources; if so, the credit creation may be said to produce a kind of “forced savings.” But let us be clear about the circumstances. The forced savings materialize only when wages lag behind the rise in prices, and only while the public is willing to hold a more or less normal amount of cash, or perhaps even add to its cash holdings. Such additions were made during the war and for a time during the subsequent period of reconstruction, when the public regarded the price increases as inescapable, attributable to the war. But once the idea of the influence of the war receded into the background, people would no longer accept this as an excuse; they not only began to protest when living costs rose, but also took steps to protect themselves. Workers demanded wage increases sooner than before (and often insisted on index-tied wages), and people in some countries began to hold as little cash as possible—hastening to buy whatever they could to avoid loss of real earnings. When that happened, not only did the forced savings disappear, but the normal flow of voluntary savings was diminished, and what remained was increasingly directed to speculation in real estate and in stocks, and to other ventures which were looked on as a hedge against inflation.

Then the game was up, for without a ready flow of genuine savings no economic progress can be sustained. In more and more countries the authorities are beginning to realize that monetary stability is the only reliable basis for sustained economic growth. The Russians know this, as I have already pointed out. A well-known international negotiator from one of the underdeveloped countries was last autumn in Moscow and discussed this and other matters with the Russian central bank. When he came back to Washington he told Mr. William McChesney Martin and myself that in comparison with the Russian central bank, both the Federal Reserve System and the International Monetary Fund could be regarded as liberal and openhanded in their attitudes and actions.

Credit Management

Let us now look more precisely at the management of credit in this country, with special attention to some possible lines of action by the Federal Reserve System. Suppose there was an expansion of credit, aided by the Reserve System through the purchase of long-term bonds, which would add artificially to the funds available
for long-term investments. We all know, without further explana-
tion, that credit creation for the financing of a budget deficit must
be regarded as inflationary because the new money is immediately
spent on payments for goods and services, and thus additions are
made to demand without any corresponding addition to current
supplies of goods and services in the market. But very much the
same happens if, at the time of a boom, when there is already a
strong demand for capital, newly created money is pumped into
the long-term market; that money will almost immediately be spent
on investment outlays by those who obtain the funds, i.e., be used
in payment for materials and for wages, and this will lead to further
purchases of goods and services, with very much the same conse-
quences as the financing of a budget deficit by credit creation.
That is why it is wise for central banks to stay out of the long-term
market, except perhaps for the purpose of ensuring an orderly
market, and then without pumping into the market, on balance,
any artificially created funds.

In the short-term market it may be equally dangerous, especially
in a boom, to extend credit, but there the transactions are in any
case more easily reversed. But it should be emphasized that there,
too, it is dangerous to seek to maintain a wrong rate, for if the rate
is too low it gives rise to speculation and overexpansion, especially
by people trying to borrow in the short-term market for long-term
purposes. Normal business need not be, and is usually not, affected
by an increase in interest rates; the important thing is to avoid
such changes in business attitudes as would have occurred if the
interest rate had been maintained at the wrong level. Some people
seem inclined to think that the continuation of more or less normal
borrowing for most economic activities when interest rates are
increased means that the increase has no effect; but that is not true,
for we have always to consider what would have happened if the
interest rate had not been increased. To give a simile: a man puts
on his overcoat when it turns cold and feels as warm as before.
Does this mean that putting on the coat has had no effect? Of
course not! He would have felt uncomfortable and might even
have caught a cold if he had not put on the coat.

I do not mean, of course, that credit should never be expanded;
but the expansion should take place at the right moment. We all
know that it has become the policy of the leading central banks—including the Federal Reserve System—to exert restraint in a boom and to give a stimulus, by credit expansion, in a recession, with interest rates at any given time being allowed to vary in conformity with market forces, as affected up to a point by official policy. It is my impression that these principles are becoming accepted almost universally. Recently the Bank of England withdrew from the long-term market, except for minor interventions to help in smoothing out quotations. The Bank of England felt that it could not “spit against the wind,” as I was told by an Englishman the other day. The Federal Reserve System employs a rather different technique from the Bank of England, showing more hesitation over smoothing out operations, but in substance the difference is not as great as it is sometimes said to be. The Bank of England does not think that there is any reason, and certainly not in a boom, to pump new money into the long-term market; and most central bankers on the continent of Europe are equally—or even more—anxious not to do so.

**Importance of Interest Underestimated**

How can we then explain that the effectiveness of flexible interest policies is often denied, and that even the Radcliffe Committee was very hesitant in recognizing the influence of interest changes when it dealt with this matter?

I think that there were certain rather peculiar reasons for this hesitancy.

We will, I think, all admit that there may be certain overwhelming influences, such as a big budget deficit, which are so strong that little effect will be exerted by changes in interest rates—and for a long time after the war public finances in many countries were not in a state to allow the interest rate weapon to exert its proper influence. May I go back for a moment to the analogy from the field of biology to which I have already referred? Then I spoke about the homeostatic system of adjustment through which body temperature is kept normal. It has been found that if the body temperature rises to something like 107° Fahrenheit, perspiration and other balancing influences are no longer sufficient to hold down the temperature—the system breaks down. Thus the stabilizing factors are able to exert a self-adjusting influence only within
certain limits; and something similar applies to the credit system. Too large a budget deficit makes it impossible for changes in interest rates to be effective; and mistaken cost and wage practices may also impair the effectiveness of the interest rate weapon.

Another limiting factor may be that liquidity in the economy is excessive, as it was in most countries after the war. Then the rate of interest could not exert its proper effect. It was only when the excess liquidity had been worked off that interest rate changes could take effect. According to the statistical evidence in a great many countries, the level of liquidity had more or less returned to normal by about 1957—and we find that in Great Britain, on the continent of Europe, and here in the United States, interest rates clearly began to be effective during the course of that year.

If we now look back at the evidence submitted to the Radcliffe Committee (published in four volumes about a month ago) we find that that evidence was nearly all presented before the autumn of 1957, i.e., before the increase in the Bank of England discount rate from 5 to 7 per cent, which took place in September 1957—an increase which was most helpful in restoring confidence in the pound sterling on the exchange markets. The London Times remarked, when it reviewed the four volumes of evidence, that most of the evidence—since it was based on experience before the autumn of 1957—"reads as if it referred to a past age." It is a pity that this was the case—but it is at the same time rather comforting for us to know that we have had so much useful experience in the years that have passed since the Radcliffe Committee heard the evidence upon which it based its report.

The excess liquidity of the postwar years took the form of large bank deposits, and of large holdings of short-term debts—mostly Treasury bills. Now that a better balance has been achieved between the amount of liquid funds and the gross national product, it is most important to prevent any new deterioration toward greater liquidity. That is just the danger in the debt management policies followed during recent years here in the United States, because the 4¼ per cent limit has forced the Treasury to issue rather short-term securities. The average length of the debt has been reduced in the last two years—which is the opposite of what ought to have happened. It may be that because of the present
decline in interest rates the immediate difficulties arising from the 4¼ per cent limit will be reduced, but I regard it, even so, as very dangerous to maintain this artificial limit. These are man-made difficulties. Somebody has pointed out that there is a certain similarity between golf and life; bunkers are among the most troublesome hazards on the golf course, and in life, too, the worst difficulties are often man-made. Mr. William McChesney Martin has likened the attitude of those who want to maintain the 4¼ per cent limit to the action of King Canute when he ordered the tide not to rise, for the attempt to prevent interest rates from rising in a boom would be as unsuccessful as King Canute's command to the tide. But the attitude of those who want to retain the 4¼ per cent limitation is even more preposterous than the action of King Canute. These people know, I think, that in a boom market rates of interest are bound to rise, but somehow they want the rates held down for government issues. It is as if King Canute had been willing to admit that the tide would rise—only insisting that it should not rise just on the stretch of the shore where he was sitting.

I have had occasion to discuss these matters with a number of persons interested in politics in Washington, and have come across some astonishing propositions. One man told me that he had nothing against rates rising for business loans, as long as the Federal Reserve System kept down the rate for government issues (he thus reasoned in the manner I had just assumed when I referred to King Canute). I asked him if that would not have as a consequence that holders of short-term government securities would demand cash payment, and invest the amounts in business securities with higher rates of interest. He replied frankly, "I had not thought of that."

It seems that there are many who tend to regard interest rates as something that can be freely manipulated. These people pay no attention to the wider functions of interest rates as I have tried to describe them to you. They are not aware of the role of interest rates in the mechanism of balancing supply and demand for funds for investment, in relation to international movements of funds, as a factor influencing the degree of confidence in the dollar, as a capitalization factor, or as a cost element in the price structure. Balance of payments considerations seem especially to be
anathema to them. I sometimes tell these people that it is of great value to the United States that the policies pursued by the Treasury and the Federal Reserve System have helped so very much to restore confidence in the dollar. I have explained that the Federal Reserve System is respected everywhere except in certain circles in Washington. I might add that I personally never open a conversation with regard to these matters. It is only when I am asked about them that I venture an opinion, but then I naturally have to say what I really think.

The other day somebody explained to me that this is an old story in American politics. The Democrats, he said, have always stood for easy money, and he referred to William Jennings Bryan’s campaigns in which that famous orator complained about the stringencies of the gold standard; and these complaints—I was told—have their counterpart today in the demands for easy money. “Yes,” I replied, “I know about these campaigns of William Jennings Bryan. He spoke violently on this subject and was defeated three times.”

I have, of course, met similar reasoning among politicians in other countries. One might wish that they did not have these attitudes, but it is not possible to ignore them, for they belong to the world in which we live. Economics is the study of the economic behavior and ideas of human beings, including the behavior and ideas of politicians.

But let me return to the consequences of changes in interest rates. There was an interesting article in the London Times of the 25th of January this year by Mr. S. Paul Chambers, the Chairman of Imperial Chemical Industries (and previously the Chairman of its Finance Committee). The title of his article was “Industry and Money Rates,” and he explained in the article that in a period of inflation—even creeping inflation—the cost of increasing interest charges counts for every little. As long as it is believed that inflationary forces will continue, there will—he wrote—be great competition for the building resources necessary to set up new plants quickly, and current rates of interest will have little influence. This, he added, was virtually true for the whole period from the end of the war until nearly the end of 1956.

Once inflationary conditions have changed, however, there will be—he said—more caution. Industrialists will realize that it may
be difficult to sell the whole production of a plant because capacity is unused. Then there will be reluctance to put up more plants; thus it is more the anti-inflationary policy than variations in costs for short-term borrowing that will be decisive. He did not specifically mention long-term rates, but the indication is, if I understand him correctly, that changes in these rates will have more influence on business decisions than short-term rates.

It is my belief that world inflation is now over. We have had low raw material prices even in this present boom; and there is strong competition in manufactured products; budgets are better balanced, and credit is restrained in a great many countries. I don't mean that there will be no price increases, but they will not be, I think, of a generalized character like those we have seen over the last twenty years. If it is true that postwar inflation is over, I think that changes in interest rates are likely to be more effective now and in the years to come. I have the impression that new market forces are operating in that direction. People make, for instance, more readily comparisons between bond yields and other yields.

Causes of Changes in Interest Rates

I would probably be wise if I refrained from any attempt to try to explain recent interest changes in this country. But I will, nevertheless, put forward some tentative ideas.

In the first place, I think that there really is a growing feeling that inflation may be over. In the past, whenever there has been a transition from the mentality of inflation to the expectation of a more stable price level, there has generally been a period of hesitancy in the behavior of businessmen and of the general public. It seems that in these circumstances those who possess funds do not immediately want to buy stocks or bonds, and often hold back a little on investment in plant and equipment. People prefer to be "liquid." They show what has been called a "liquidity preference." They naturally want to earn what they can on their liquid funds, and they therefore buy Treasury bills, with the result that the rate of interest on such bills is reduced.

This is the first phase—the phase of hesitancy, and this is the position, I believe, in the United States today. The second phase follows, for thanks to the accumulation of liquid funds, there is
more money waiting to be permanently employed. There is then
what Montagu Norman, the Governor of the Bank of England,
used to call an increasing "weight of money" in the market—an
expression which I have never heard used in this country, and one
that is now rarely heard in England; but I think it gives a useful
picture of the next phase in the change. How that "weight" will
make itself felt is perhaps not easy to tell, but as far as this country
is concerned, most of the money that is now being accumulated is
good money—money saved in pension funds and so on—and that
money will, I think, before long seek a more permanent place of
employment, and may then exert a steadying influence on capital
values.

Generally speaking, we are now in an era in which we all shall
have to learn how to live without inflation. It is in my opinion a
good thing that this change in attitude has occurred at a time when
there is still a boom in Europe and quite good business here in the
United States. To learn how to live without inflation is at first not
an easy matter—it involves, for instance, greater attention to costs,
including wage costs. For many reasons increased attention to costs
is required here in the United States. I think, as I have already
mentioned, that by its budget policy, the Government, and by its
credit policy, the Federal Reserve System, have done what they
could to arrest inflation; now business and labor leaders and the
general public will have to adjust their behavior to the new
conditions.

I am fully aware that there are many questions relating to the
availability of funds and other matters with which I have not been
able to deal here today, which I regret—but there is no time. But
before I end I should like to add a few words about the influence
of the leading countries on general monetary developments in the
world. That the measures of fiscal and credit policy which are
taken by these leading countries will exert a direct influence on
world affairs is, I think, self-evident, so I need not take up any
time in elaborating that point. But these countries also exert an
indirect influence because they influence thinking and behavior in
other countries. I remember what happened after the war when
some of us in the Bank for International Settlements tried to
persuade various countries to pursue flexible credit policies, and
especially to discontinue their support of government bonds at
pegged prices. We had some success with countries on the continent of Europe that had suffered from galloping inflation, or observed such inflation at close quarters in neighboring countries, but we had little or no success at all when it came, for instance, to the Scandinavian countries, which had not themselves suffered much from such evils in the past. Those with whom we talked in these countries quite rightly pointed out that the bond markets continued to be supported in London and in New York, and asked us if we in Basle really thought that we were wiser than those who decided these matters in London and New York and Washington. I must admit that that was what we probably did think, and we were of course encouraged by the fact that many of our personal friends in England and here in the United States held the same opinion as we did in Basle.

It was hard—I tell you—to persuade the countries in this respect. It was not until 1951, when the Americans and the British allowed their interest rates to move, that the idea of the usefulness of flexible credit policies really began to gain ground. The world has moved a long way since then. I feel sure that we are now in a position to ensure sound monetary policies in most countries, and we shall thus be better able to establish a more smoothly working monetary system in the Western world than we have had for a long time.

There is no doubt that difficulties will be experienced in the newly established countries around the world. They will be tempted, when their own savings are scarce, to turn to credit creation for the financing of development projects. It is our hope in the International Monetary Fund that through the contact we have with these countries we shall be able to impress upon them that they, too, are best served by basing their economic growth on monetary stability. Personally, I often tell these countries that I do not think that they have obtained any dispensation from the application of the ordinary credit principles. But I am sure that once again the attitudes and actions of the leading countries will be of decisive importance for the formation of a sound world opinion in this field. We have to take for granted that in these new countries government action will play a great role. There will be much economic management, and it will therefore be necessary to try to prove to these countries that management can only succeed when it is in conformity with the basic principles of a free economic system.
We have good reason to remember ourselves, and to remind others, of the profound wisdom of Bacon's saying, which I have already quoted, that "nature can be commanded only by obeying her." We cannot escape the task of trying to hold together the Western world in the kind of free system to which we are attached. There will have to be a balance of responsibility between the efforts made in each one of the new countries, and the assistance that is provided from abroad. But much will also depend on the behavior inside the leading countries—whether or not they pursue flexible policies in the management of their affairs. The United States, which must now be regarded as the leading country in the economic and financial affairs of the world, and which is the home of the International Monetary Fund and the International Bank for Reconstruction and Development, has, I think, a special responsibility to manage its own economy well, and thus to provide an example which will influence thinking and behavior all over the world.
The Fund in 1959/60 *

In April 1957, when I appeared before you the first time, the strain, especially on sterling as a result of the Suez crisis, had not yet been overcome; at the same time, the balance of payments position of many countries was affected by the intense economic boom in almost all the industrial countries. In addition, rumors about a possible revaluation of the deutsche mark had begun to circulate, and, together with other factors, ushered in a period of acute tension in the foreign exchange markets of many countries. It was a very difficult situation indeed.¹

By the time of my next appearance before this Council, in April 1958, effective steps had been taken to eliminate the tension and to restore a fair degree of calm in the exchange markets. But, at the same time, there were increasing signs of a recession in the industrial countries, and considerable concern was felt about the general liquidity position of the world.²

A year later, in April 1959 when we met in Mexico City, the general situation was much more reassuring.³ At the end of 1958, 14 European countries had established external convertibility of their currencies, and quite a few countries in other parts of the world had taken similar steps. There were distinct signs of a recovery in economic activity; but it could not be taken for granted either that the convertibility moves would prove successful or that the recovery would continue; and it was not at all clear how these developments would affect the primary producing countries.

Now, in April 1960, we can feel satisfied that the steps taken by the European countries at the end of 1958 have been crowned with success. The monetary reserves of these countries have been substantially increased, and the reliance of these countries on dis-

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¹ Address before the UN Economic and Social Council, New York, April 8, 1960.
³ See above, page 35.

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Crimination in payments and trade has been very much reduced. Economic activity has continued high in these and other industrial countries, but under conditions which have not led to any appreciable increase in the average level of raw material prices. It seems, however, that the volume of international trade is again rising, and this should help the marketing of products, even where prices have not risen much. Moreover, in many of the primary producing countries steps are being taken to overcome inflationary pressures and in that way to make the best use of the resources available for development.

*Assistance from the Fund*

The improvements which have taken place have, of course, been due primarily to the determined actions of individual countries. But the International Monetary Fund has been able to make its contribution. The financial assistance granted to member countries by the Fund since the difficulties became acute at the end of 1956 amounts to the equivalent of over $2 billion. This is the most spectacular part of the Fund's contribution, but only a part. The Fund has also extended technical assistance and has helped in the preparation of stabilization programs, as a result of which further funds have been obtained from a variety of sources.

It is always dangerous to exaggerate and to be complacent about the degree of improvement that has been attained, since new and perhaps equally difficult problems are bound to arise; but it would also be a mistake to minimize what has been achieved. In quite a number of countries, the increase in the cost of living has been moderate for well over a year; this has helped to strengthen the confidence of the general public in the value of their currencies. In other countries, where prices have not been so stable, people have begun to feel that they have had enough of inflation, and the authorities in these countries can now count on much greater popular support for their efforts to resist inflationary pressures, even when rather harsh measures have to be taken. There is also a growing conviction, evidenced by statements at the last Annual Meeting of the Board of Governors of the Fund, that monetary stability is the only reliable basis for sustained growth. These are real gains; they provide a foundation for us to proceed further, and
to apply our minds to the problems that remain as well as those that will arise in this ever-changing world. . . .

The success of the Fund, as a center for monetary cooperation, will always depend upon the maintenance of close contact with member countries. Such contact is of importance not only in times of tension and crisis, but also in periods of general monetary stability—for even then problems of monetary management may well arise. These are often of an intricate nature and may require coordinated action by a number of countries. . . .

Stabilization Programs

I may perhaps say a few words about the stabilization programs which had already been put into effect when I appeared before you a year ago. In 1959, France had a balance of payments surplus of over $1 billion on current account, and was able to add substantially to its monetary reserves and at the same time to repay a considerable part of its foreign debts. Notable progress has also been made under the stabilization programs in Argentina, Bolivia, Chile, Colombia, Haiti, Honduras, Mexico, Paraguay, Peru, and Turkey. The Fund has maintained close contact with these countries, and more often than not this has involved the conclusion of new stand-by arrangements, which have contained provisions for such further measures as have been needed to continue the improvement.

As is clear from the list of countries that I have just given, the Fund’s activities in support of stabilization programs have been particularly marked in Latin America, both among the northern group of countries and in South America, and the progress that has been made is all the more remarkable in view of the fact that, on the whole, world prices of the raw materials produced by these countries did not improve during 1959, except for copper and a few other metals. This progress has been the result of the very determined efforts made by these countries, aided by financial and advisory assistance from the Fund and supplemented by resources obtained from U.S. Government agencies and U.S. and European commercial banks.

Among the northern group, the Fund continued to play an important role in the implementation of stabilization programs
THE FUND IN 1959/60

during 1959. It contributed to the strengthening of the position of
the Mexican peso and gave financial assistance to Haiti, Honduras,
and the Dominican Republic—where a stabilization program was
introduced in December.

It is among the countries of South America, however, that
efforts toward the achievement of stability have been most difficult
and the greatest sacrifices have had to be made. This is partly the
result of the long history of inflation in these countries, associated
with complex multiple currency practices, and partly the result of
structural problems. The importance of stability, however, in
enabling the best use to be made of scarce resources in the efforts
to diversify and develop the economies of these countries, and the
value of raising real wages rather than money wages in the long
run, cannot be overrated.

As the domestic financial position of these countries improves,
so internal production should increase and a better climate be
created for sound development. I do not wish to convey the
impression that the problems of Latin America have been solved,
but I think it particularly significant that these countries are apply­
ing themselves in an increasingly determined fashion to the task of
eliminating inflation, simplifying their exchange systems, and
developing their economies under a system of freely convertible
currencies.

Of the new stabilization programs with which the Fund has been
concerned in the past year, two were put into effect by European
countries. In July 1959, the Government of Spain presented to the
Fund and to the Organization for European Economic Cooperation
(OEEC) a comprehensive stabilization program, which included
budgetary reform, credit restraint, and unification of the exchange
structure at a realistic rate of exchange, together with measures
for the liberalization of trade. In support of this program, Spain
drew from the Fund the equivalent of $50 million in U.S. dollars,
sterling, and French francs, and entered into a stand-by arrange­
ment for a further $25 million; at the same time, it became a
member of the OEEC and was granted a credit of $100 million
from the European Fund. In addition, $200 million was obtained
from various U.S. sources, including $70 million from U.S. com­
mercial banks. It can already be said that the steps taken by the
Spanish authorities have had a considerable effect. They have
resulted in a virtual elimination of inflationary pressures and in a greater freedom of trade and payments which, together with the reduction in discrimination, has created the conditions for the realignment of the Spanish economy with the economies of the other countries of Western Europe. The stable exchange quotation for the peseta is evidence of Spain’s improved balance on foreign account; and since the stabilization program was introduced, more than $200 million has been added to reserves over and above the amounts drawn under foreign credits.

In February 1960, the Government of Iceland presented to the Fund and the OEEC a comprehensive stabilization program which aimed at the achievement of internal stability and external balance in Iceland’s economy. The program included the elimination of multiple exchange practices and the introduction of a new par value for the Icelandic kröna. In support of this program, Iceland drew $2.8 million from the Fund and entered into a one-year stand-by arrangement for a further $5.6 million. At the same time, Iceland was granted a credit of $12 million from the European Fund.

In connection with these two stabilization programs, and in the general exchange of relevant information and views, the Fund has continued to maintain close and friendly relations with the OEEC, and basic harmony has prevailed between the two organizations in the pursuit of common objectives of monetary policy.

Stand-By Arrangements

I am also very pleased to be able to tell you that, two days ago, the Fund entered into a stand-by arrangement under which Venezuela can draw up to the equivalent of $100 million in support of its efforts to achieve economic and financial stability. The Fund is making available $15 million before, and a further $85 million after, Venezuela completes the necessary legislative steps to increase its quota in the Fund from $15 million to the $150 million which was approved by the Fund last year. Largely because of the settlement of obligations inherited by the present and immediately preceding Government, for two years to the end of 1959 the Venezuelan budget showed a substantial deficit, and credit was expanded, leading to a fall in reserves. Since then the Government has taken steps to reduce expenditures and to avoid inflationary
financing. Now a comprehensive program has been adopted under which government expenditure on current and capital account will be kept to a level that can be financed by ordinary revenues and long-term credits from abroad, and under which a cautious credit policy will be pursued. The Venezuelan Government will continue to maintain the convertibility of its currency and will avoid trade and exchange restrictions.

Hitherto I have spoken of financial assistance in support of stabilization programs, and it is satisfying indeed that this has again been one of the main features of the Fund’s work. But it should be emphasized that the Fund’s participation in these programs is not confined merely to providing financial assistance. The Fund maintains constant contact with the member country throughout the period of any stand-by arrangement, often through a resident staff official when this has been requested. This enables the Fund to give technical assistance and advice on any problems that may arise during the implementation of the program.

In addition to assistance in connection with stabilization programs, use has been made of the Fund’s resources to assist countries which have large seasonal swings in their balance of payments. In such cases, resources are made available for such short periods as are appropriate to the member’s problem, and repurchases are usually made within, say, six months, when the seasonal pressure has passed. In the past, this type of assistance was given to a considerable number of countries, particularly in Central America, but many of the countries availing themselves of this temporary assistance have in recent years found it necessary to adopt more general stabilization programs, and have then come to the Fund for longer-term assistance under stand-by arrangements.

These stand-by arrangements correspond rather closely to what in ordinary banking parlance are called “lines of credit.” Experience gained in recent years has shown that even when these stand-by arrangements have not been fully used—or not used at all—they have nevertheless effectively helped to sustain confidence in the members’ currencies because it was known that the countries had those resources at their disposal. While the Fund has no power to create credit directly, since amounts drawn by one country are obtained from the country whose currency is drawn, it is interesting to point out that stand-by arrangements, which by their very
existence strengthen the reserve positions of the countries concerned without any money being drawn, act in many ways as a form of credit creation.

Effects of External Convertibility

When, at the end of 1958, 14 European countries introduced external convertibility, it was thought by many that this was a more or less formal step, simply recognizing what had already been achieved. But the decision soon proved to have been of really great significance. It led to a simplification of formalities, which was in itself not unimportant. It created a feeling, which soon spread, that the steps taken would not be reversed; in that way, confidence in the international monetary structure was greatly strengthened. When during the course of 1959 the monetary reserves of most industrial countries showed quite substantial increases, the fears and apprehensions about balance of payments difficulties—which had plagued so many countries in the postwar era—began to disappear. Then it became clear that many of the practices of those years would also have to disappear. There were, indeed, no longer any good reasons for maintaining discrimination in trade and payments for balance of payments reasons. These matters were discussed at the Annual Meeting of the Fund Governors at the end of September 1959; and in October, the Board of Executive Directors unanimously approved a statement that, in view of the substantial improvement in the reserve positions of the industrial countries in particular and the widespread move to external convertibility, the Fund considered that there was no longer any balance of payments justification for discrimination by members whose current receipts were largely in externally convertible currencies.4

This decision on discrimination for balance of payments reasons was communicated to the Contracting Parties to the General Agreement on Tariffs and Trade, who were then meeting in Tokyo. A statement issued at the conclusion of the meeting of ministerial representatives of the Contracting Parties expressed views similar to those of the Fund decision. The statements by the Fund and the Contracting Parties were the logical conclusion of the

move to external convertibility, for, when currencies are externally convertible, there are no monetary reasons for preferring imports from any one country rather than from another.

Since the convertibility move in December 1958, improvements in the international reserves of so many countries have also made possible the elimination of many nondiscriminatory quantitative restrictions. It is very satisfying to be able to report that in the last six months such determined steps have been taken by countries in Europe and by certain other countries to reduce discrimination against imports, from the dollar area in particular, that over a fairly wide area discrimination is becoming more and more a thing of the past. In these countries, most of the restrictions on current transactions that remain today are nothing more than protectionist devices or are considered necessary in relations with state-trading nations.

While progress in the elimination of discrimination and quantitative restrictions has been particularly marked in Europe, it extends to other parts of the world, and the restrictions that still remain generally cover a decreasing proportion of the foreign trade of the Fund member countries. The elimination of discriminatory restrictions is, of course, important because it provides an impetus to the balanced expansion of world trade and to the removal of distortions which are economically harmful. At the same time, it removes a cause of dangerous tension between trading nations, for discrimination that is no longer manifestly essential is bound to be regarded as unfair and as such is likely to provoke retaliatory measures, which in their turn will further hamper the growth of trade. While there are still many steps to be taken, considerable advance has been made during the past year "in the elimination of foreign exchange restrictions which hamper the growth of world trade" 5—to quote from Article I of the Articles of Agreement of the Fund. . . .

*Increases in Quotas*

The increase in the Fund’s resources, which was already on the way when I spoke to you a year ago, has now come into effect. . . .

5 Article I (iv).
In round figures, members’ quotas now total $14 billion, having been increased by nearly $5 billion, and the Fund holds $3 billion in gold and $10.5 billion in currencies. Since the moves to external convertibility at the end of 1958, the greater part of these currency holdings are now externally convertible and thus readily usable for international transactions.

Through the increase in quotas, individual countries have acquired additions to their “second lines of reserves,” for they can now draw larger amounts from the Fund in case of need to supplement their own holdings of gold and foreign exchange.

Because of this second line of reserves that is available to them in the Fund, a feeling of confidence is created among Fund members even though the resources directly under their control may be considered not adequate to meet every eventuality. Members can therefore safely make their decisions with respect to the freedom of payments and trade without having to pay undue regard to such temporary balance of payments difficulties as may from time to time occur.

The increase in the Fund’s resources came at a time when, for a number of reasons, the world’s liquidity position was improving quite rapidly. The official reserves of the Western European countries and Japan increased by the equivalent of about $3.5 billion between the end of June 1958 and the end of December 1959. This increase took place despite payments by these countries of the equivalent of about $1 billion to the Fund in respect of repurchases and gold subscriptions on their increased quotas. Even the figure of $3.5 billion does not tell the whole story, for at the same time the foreign exchange holdings of commercial banks increased considerably in a number of countries. Exact data are not available, but for Western Europe the increase would seem to have been as high as $1 billion over and above the increase in official reserves in the eighteen-month period.

Rebuilding European Reserves

It would not have been possible for these countries in particular to add so substantially to their reserves had it not been for the deficits in the U.S. balance of payments, by which $3.4 billion in 1958 and $3.7 billion in 1959 were made available to other coun-
tries. Since the United States still holds half of the Western world’s gold reserves, this outflow caused no particular strain on its liquidity position, while it greatly helped the general position by bringing about a useful redistribution of the world’s monetary reserves. It is instructive to contrast this situation with what happened in the years from 1926 to 1930 when many European countries were striving to build up their reserves after the reductions that had occurred during and just after World War I; then the gold markets were submitted to a considerable strain, which was a contributory cause of the subsequent crisis. The fact that the process of rebuilding the reserves of European countries has this time been so relatively smooth has certainly been due, to a decisive extent, to the outflow of funds from the United States that has taken place.

Valuable as this outflow of funds from the United States has been in many respects, it could naturally not be allowed to continue indefinitely on such a scale; in taking corrective measures, the U.S. authorities have turned primarily, as others have done in similar situations, to measures of fiscal and credit restraint. As the recession of 1958 gave place to an upturn of business in the course of the following year, it became appropriate from a domestic point of view to limit the expansion of credit and to aim at a budget surplus. Under the impact of such measures, there has been a widening resistance to price increases, both wholesale and retail, in the United States, and this seems to have been followed by increased attention to costs. With the upsurge in business activity more pronounced in Europe than in the United States, there are now signs of an increase in U.S. exports, together with a reduction in the over-all deficit in the U.S. balance of payments.

After the upheaval of a world war, it necessarily takes time before the relations between domestic costs, prices, and liquidity are properly adjusted in each country and before a proper adjustment of these factors is made between different countries. Marked and persistent disequilibria, when they occur, may have to be corrected by alterations in exchange rates—but such alterations have many, often unexpected, repercussions and should be reserved for cases when other measures fail to produce the necessary adjustments. The re-emergence of Western European countries with great productive capacity and strong competitive power has, of course, introduced a new element affecting the balance of the world economy.
But when these matters are discussed—and much is heard about the replacement of what was called “the dollar shortage” by “the dollar surplus”—it should not be forgotten that the United States still has a surplus of exports over imports, with a tendency in recent months for this surplus to increase.

In general, movements of gold and exchange balances, which take place as monetary reserves are being increased or decreased, themselves set in motion corrective forces which tend to establish equilibrium. Much progress has already been made toward a lasting equilibrium, and it seems that the present structure of exchange rates will on the whole prove durable, and that the par values already agreed with the Fund will generally be maintained . . . .

While those who follow statistics of reserves and balances of payments will find impressive indications of a strengthening of the world’s monetary structure, the general public is more concerned about what happens to the purchasing power of money—in other words, to the prices they have to pay for the goods and services. Some prices may still be rising, but for not a few goods prices are declining in many parts of the world, especially if improvements in quality are taken into account. The greater degree of price stability now noticeable in many countries has therefore helped to produce more confidence in money than existed only a few years ago. With this increase in confidence, the desire to hedge against inflation which has been the practice until quite recently has distinctly weakened. The decline in stock-exchange prices, which has been such a notable feature in several countries during the opening months of 1960, is certainly not unconnected with the growing disbelief in continued inflation. At the Annual Meeting of the Board of Governors of the Fund last September, I ventured the statement that in all likelihood world inflation was over—and I have no hesitation in repeating that statement here today.

**Stability of Prices**

Even in the recent period of a distinct upturn in business activity, the index of prices of raw materials has shown remarkably little increase, while the index of prices of foodstuffs has fallen. In the

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6 See above, page 108.
important field of power, there is a plentiful supply of both coal and oil, freight rates are still relatively low, and there is much greater competition for almost all kinds of manufactured goods—and this competition is particularly intense in the export trade. Moreover, efforts are being made in a great many countries to reduce budget deficits and, in some countries, to aim at a budget surplus—measures which, together with more cautious credit policies, are the proper measures in a boom. This being the general picture, it is hard to see how there could be such a change in demand and supply conditions that would cause any appreciable rise in prices on world markets.

The world seems now to have reached a stage where the impact of excessive liquidity and certain other influences emanating from the war have spent their force. Therefore, the expanding production of goods may be counted on to prevent appreciable increases in world market prices over the next few years at least. If the trend of international prices is steadier, any individual country that embarks upon inflation will do so at much greater risk, for gone are the days when any one country that inflated might hope to be saved by inflation elsewhere. Any country which today permits the price level to go on rising will be exposed to balance of payments difficulties, and also before long, as its competitive power declines, to a deterioration in its employment situation. There has been a growing realization of such dangers; and in more than one country, the possibility of such untoward developments has been cited as an argument in favor of more cautious fiscal and credit policies.

May I refer again to the fact that in the recent period of great business activity in the industrial countries there has been, on the average, little increase in the prices of primary products. It is true that the prices of certain raw materials have risen, but the prices of most foodstuffs and some other commodities—including oil and coal—have fallen, and more or less offset the increases. Thanks to brisk demand, it has generally been easier to dispose of accumulated stocks—and that has been an advantage—but there has not been the general advance in prices that might have been expected at a time of booming business in the industrial countries. For the primary producers this has been a disappointment—and the implications of the recent price movements should be carefully considered, not only by the primary producers themselves but also by the industrial coun-
tries. The primary producers need to make every effort to rationalize the production of their basic commodities and to diversify their economies. They will naturally have to rely to a large extent on their own efforts; and it is in their interest to pursue policies which are most likely to have the effect of mobilizing all their own available resources, and which will enable them to use these resources, and any that can be obtained from abroad, in the most effective way. For this reason it is particularly important that they avoid inflationary financing, for this not only discourages domestic savings but leads to the dissipation and misuse of scarce resources. By demonstrating its ability to run its domestic affairs competently, a country becomes more creditworthy and more able to attract capital from abroad—from both official and private sources.

There is undoubtedly a growing awareness in the industrial countries of the vital importance of assisting the less developed countries, and much thought is being given to the way in which assistance can best be arranged. But such resources as will be made available—and they will always seem limited in relation to the requirements around the world—can be used really effectively only if the earning potential of the developing countries is safeguarded and strengthened. In a situation in which there is little likelihood of any significant increase in the prices of primary products, it becomes all the more important to facilitate the marketing of their main products and any other commodities which they might be able to export as a result of the diversification of their economies.

Thus the tariff and other trade policies of the industrial countries become a matter of primary importance. In the world today, there are certain gratifying tendencies toward reductions of tariffs, which, however, seem to be largely to the benefit of trade in manufactured articles. Every effort must be made to facilitate trade in primary products as well, and to ensure that, whatever other steps may be taken, no additional obstacles of any kind are put in the way of such trade. There is therefore a special responsibility incumbent upon all those who are now considering trade arrangements in Europe and in other parts of the world. There is no doubt that trade is more important than aid, particularly for the development of the primary producing countries; and if aid is to be effective, trade must be given its proper chance.
Fluctuations in Export Earnings

One particular aspect of the problems now facing the less developed countries is concerned with the difficulties arising from the instability of export earnings that comes from marked variations either in world prices of primary products or in the volume of production and sales. At the request of the United Nations Commission on International Commodity Trade, the Fund has prepared a study of its policies and procedures in relation to the compensatory financing of commodity fluctuations, and this study is being transmitted to the Commission on International Commodity Trade for discussion at its Eighth Session.

The Fund has on many occasions provided assistance to members in temporary balance of payments difficulties resulting from fluctuations in their export earnings, and members can have confidence that Fund assistance, in conjunction with a reasonable use of their own reserves, will be sufficient to enable them to overcome such temporary payments difficulties. It would, however, be neither practicable nor desirable to make the amount of Fund assistance dependent on any automatic formula related to fluctuations in the proceeds of exports, or to provide any separate form of Fund assistance to deal with export fluctuations alone.

While the primary producing countries can themselves do much to keep their economies on an even keel despite fluctuations of world markets, and while access to the Fund’s resources should go far to relieve their payments difficulties arising from this source when they are of a temporary nature, the industrial countries also have a considerable part to play in keeping world markets relatively steady. In the first place, they should continue their efforts to mitigate the sharp fluctuations in their demand for primary products, such as arise from booms and recessions, and, in particular, to avoid any danger of a relapse into a deep depression such as occurred in the 1930’s. Secondly, they can ensure that their arrangements for the protection of domestic agriculture do not exercise a depressing or disturbing effect on world trade in primary products. Thirdly, they can increase their efforts to provide an adequate and stable flow of long-term capital to the less developed

7 Staff Papers, Vol. VIII (1960-61), pages 1-76.
countries. And, finally, they can make every effort to ensure that no additional obstacles of any kind are put in the way of world trade in primary products.

From the outbreak of war in 1939 up to 1957-58, there was an almost uninterrupted increase in the general level of world prices, and the public in many countries became accustomed to such an increase—and had begun to take it more or less for granted. Now that this assumption seems no longer valid, more caution is called for in relation to cost increases and in other respects. In this new situation, new problems will arise; and the prospects for achieving a high rate of growth are often discussed. A study of the past shows that growth has occurred under the most varied conditions; we find a high rate of growth in the period of declining prices from 1873 to 1895; there was growth, perhaps at not quite so high a rate, in the period of rising prices from 1900 to 1914; there was a further period of substantial growth under conditions of a more or less stable price level in the 1920's; and a high rate in the years following World War II. As far as our knowledge goes, we cannot conclude that increasing prices are essential for growth, or that they even favor growth. Whenever there is great technical progress, and therefore a strong demand for capital, the limiting factor is the availability of savings—and confidence in the currency is without doubt more likely to ensure a higher rate of savings. There is, therefore, every reason to affirm that the maintenance of a relatively stable price level provides the most reliable basis for sustained growth. But one proviso must be kept in mind: in each of the periods I have mentioned, economic practices generally had to be adjusted to the price trend. Practices appropriate when prices are rising would not be appropriate when stability prevails.

Now that the postwar inflation seems to have come to an end, one of the most important tasks is to learn how to live without inflation. Those who make this adjustment most rapidly will best profit from the advantages of modern techniques of production and marketing and will be able to achieve a higher standard of living. Since the experience of businessmen and labor leaders over the last twenty years has been gained under conditions of an inflationary rise in prices, there is need for a readjustment in attitudes and behavior that may not always be easy.
One of the characteristics of our economic life since the Industrial Revolution is that over and over again new situations have required a fresh appraisal of the conditions under which we can pursue our activities. Economic and social considerations are necessarily intermingled in this process, and the most favorable results will be gained when due weight is given to both economic exigencies and the desire for social improvements. In the present situation, in which it is necessary to take a new look at many problems, I believe it has been appropriate to draw attention to the changes in price trends and general attitudes that have taken place, and to the importance of finding the proper solutions of our problems in this new situation.
Monetary Relations Between Europe and the United States *

Speaking here today about the monetary relations between Europe and the United States, it may be perhaps useful if I begin by considering for a moment the situation that prevailed just before World War I. In the days before 1914, Europe was undoubtedly the financial center of the world. For the short-term financing of international transactions business people turned to London; Paris was the most important market for long-term loans; and Germany was emerging as a leading industrial country, but had not yet had time to take a prominent part in international finance. The economic strength of the United States was making itself increasingly felt, but the weakness of that country's monetary structure was conspicuously apparent—for instance in the crisis of 1907, when it became clear that a modern banking system would have to be established in the United States. That was achieved by the Federal Reserve Act of 1913, fortunately adopted in time for the Federal Reserve System to assist in the handling of the difficult financial problems of World War I and those of the postwar period.

It would be a mistake to look upon Europe's predominant position before 1914 as merely a reflection of its material strength. Equally important was the fact that the European countries had built up an organization which served the world well in the field of banking, investment, foreign exchange, and generally as a center of world trade. Great Britain was still a free trade country, and the tariff levels in most European countries were relatively low, which made it easier for the debtor countries of other continents to sell their products to Europe, and thus finance the repayment and servicing of the loans they had received. These aspects are very important: Europe provided the machinery for the smooth functioning of the world's commercial and financial system, and, at the same time, people looked to Europe for guidance.

* Speech before the California Bankers' Association Convention, Los Angeles, May 24, 1960.
After World War I, New York emerged as an important financial center, but it still did not have an international banking organization or commodity markets in any way comparable with those established in Europe. Much money was lent by American banks in the 1920's, but not all was lent wisely. Many mistakes were also made by the European countries; and, as we know, they all led to the crises of the years 1931 to 1936, with currency devaluations and much economic and financial disruption, and to the deep, prolonged depression of that decade. The world was broken up into different currency areas—the dollar area, the sterling area, and, for a time, the gold bloc, to say nothing of the Schachtian regime in Germany and Eastern Europe.

It was in this precarious situation that World War II began, from which Europe emerged very much weakened and the United States pre-eminent in world affairs. The United States used this pre-eminence through the granting of aid under the Marshall Plan, and in many other ways, with a magnanimity and generosity which, even though it may have been in its own enlightened self-interest, will stand out in history as an almost unparalleled act of statesmanship.

**Responsibilities of United States**

Marshall Aid was part of the official measures arranged between the governments of Europe and North America. The disturbed conditions of world trade and payments proved a great obstacle to private commercial lending, but even so, U.S. banks soon became more active, and the dollar acquired a notably important position as a medium for international financial transactions. It also came to be the most important reserve currency for foreign central banks and monetary authorities, and today some $9 billion is held in the United States as part of foreign countries' official exchange reserves, as compared with the equivalent of $7 billion held in sterling. In addition, some $7 billion is held in the United States by banks, public companies, and private individuals abroad, and this compares with the equivalent of $3 billion held similarly in sterling.

In this way the United States has become a world banker—a role thrust upon it, but one which it cannot escape even if it wanted to. There is indeed no reason why it should want to escape from this task. It is an interesting and vital role, and personally I think—as
I shall try to show later on—that the necessity of having to consider outside interests and the development of the balance of payments is often helpful in ensuring the pursuit of proper policies at home. However, before I come to that part of my talk, there are two observations which I should like to make.

In the first place, I want to stress the importance of having the qualified personnel and the proper organizations in any country that has to play a central role in international finance. Many people were astonished to find how, in 1931, London was able to retain its position as a financial center after the devaluation of sterling in that year—and, in fact, that London was more firmly established than ever as the center of the important sterling area, including many countries outside the British Commonwealth. There is no doubt that the presence in London of the institutions and the trained and experienced personnel for the handling of this kind of business played a major role. Therefore it is important today for banks and other institutions in the United States to build up a cadre of trained and able persons ready to handle the affairs of international finance. Enormous progress has already been made in this respect, but a great deal remains to be done. In Europe, too, certain weaknesses have been apparent in recent years since the re-establishment of effective foreign exchange markets. For it was found that there were very few bank employees who knew how to deal expeditiously in foreign exchange, most of them having had no opportunity to do so since the introduction of exchange control at the outbreak of the war in 1939. In a more closely knit world, with expanding world trade, the personnel needed to manage overseas financial affairs must measure up to a high standard indeed; they must be capable of mastering the techniques, as well as of appreciating the wider implications, of their work.

My second observation stems from the recovery of Europe from the consequences of World War II and, in particular, from the external convertibility of almost all Western European currencies. We are once again in a situation in which there are a number of important economic and financial centers in the world. This situation poses the same problem as before—the problem of proper coordination—which was never solved in the interwar period. Today, however, there is fortunately a new element in this tangled situation: the existence of the two institutions established at Bretton
Woods, the International Monetary Fund and the International Bank for Reconstruction and Development. It is greatly to the credit of the allied governments that even while they were still prosecuting the war, they were making plans for the financial system to be established to cope with the problems that had to be solved in the postwar period.

The Fund and the Bank

The International Monetary Fund's work combines two main elements: an agreement on foreign exchange policy and the pooling of resources to assist countries in case of need to support that policy. The Fund sets as an objective for each country the establishment and maintenance of a convertible currency at a fixed par value, free of restrictions on current payments, and without discrimination. The Fund's pool of resources is considerable: the Fund has at its disposal today $3 billion in gold and $7 billion in externally convertible currencies from which assistance can be granted—assistance that is provided for general balance of payments purposes of a temporary character. Fund assistance is therefore available for from three to five years to provide time for the countries receiving assistance to take effective corrective measures. Repayments of credits granted by the Fund have been duly made, so resources of the Fund constitute a "revolving fund" in theory and in fact.

The International Bank for Reconstruction and Development, on the other hand, is an investment bank—being a long-term lending institution, financing specific projects. It has some funds of its own contributed by the member governments or earmarked as reserves from profits earned on loans granted, but to replenish these resources the IBRD has been able to borrow in the world capital markets on a large scale, and I believe that more than half of its current borrowed resources have been obtained in countries outside the United States. The loans which the Bank makes are either granted to governments and governmental agencies or guaranteed by the governments of the receiving countries. The International Monetary Fund and the International Bank for Reconstruction and Development have the same member countries—sixty-eight in all—and with so many new states emerging, it is expected that the membership may well soon exceed seventy or even seventy-five countries.
New Zealand and Switzerland are not members. In New Zealand, the question of membership became a political matter; Switzerland has been afraid that the Swiss franc, which up to recently was the only fully convertible currency in Europe, might be used in ways that the country did not want if it were a member of the Fund. But IBRD bonds have been issued on the Swiss market, so the Swiss have not refused to take part in international cooperation when no major monetary consideration was involved. Now that so many other European currencies have been made convertible, the fears peculiar to Switzerland may have lost much of their substance.

... for Fund assistance to be effective, it is necessary that the countries requesting Fund assistance should come willingly to the Fund; and a good program can be worked out only if in the country itself there are ministers and officials who are anxious to ensure that the proper measures will be taken. It has fortunately been the Fund's experience that able and conscientious men who want to see the right policies carried out are found in most countries, and the task of the Fund has been to give support to the views held by these men.

In many cases it seems to have been the practice of the U.S. Government, and of the governments of some European countries, to advise applicants for aid or loans to turn first to the Fund with a request for technical and financial assistance for their stabilization program. Thus a possible and practical solution of the problems of the country concerned has been worked out in conjunction with the Fund, and only when that has been done have the individual countries given an answer to the request for aid or loans. In that way the Fund has come to occupy a strategic position—which will not always be an enviable one.

On numerous occasions, further assistance has been obtained not only from the U.S. Government and from European Governments acting through the OEEC, but also from various U.S. Government agencies, such as the Export-Import Bank, and from commercial banks in Europe and the United States, under so-called "parallel arrangements." There has thus been coordination between the various economic and financial institutions on both sides of the Atlantic, and in particular there has been close contact between the Fund and the OEEC in the elaboration of a number of stabiliza-
tion programs in Europe. The Fund does not compete with the banking system in helping countries in difficulties. It is normally called upon to provide assistance in cases where the character of the program that is required is such that finance could not be arranged by commercial banks alone, or where the risk involved is so great that private financial institutions could not very well grant the credits needed. Once the Fund has done its work however, and conditions have begun to improve, the field is open for lending by commercial banks and for the provision of capital for various kinds of long-term investments.

I should add that, up to a few years ago, most of the financial assistance granted by the Fund was in U.S. dollars. In the last two years an increasing proportion of drawings on the Fund has been effected in European currencies, and it is expected that the proportion of currencies other than dollars drawn from the Fund will continue to increase in the years ahead.

So far I have spoken of assistance for the establishment of sound currencies, which is the task of the Fund, but there should also be coordination in the extension of aid and long-term financing generally. In the field of long-term financing, the International Bank for Reconstruction and Development has done much useful work in many ways. I would specially mention the Bank's initiative in calling together a committee representing the various countries that had given aid or arranged loans to India; in that way it coordinated the provision of funds that were made available to help to complete the financing of India's Second Five Year Plan. Such coordinated lending is in many respects more effective than bilateral loans and credit, and the decline in India's international reserves was for at least a year or so arrested. For the authorities in India knew what they could count on, and were able to arrange their own affairs more realistically.

OECD and OECD

It may thus be said that the International Monetary Fund and the International Bank for Reconstruction and Development can do much useful work in establishing relations between the authorities and various institutions in the different financial centers, but something more is needed. Now that Europe has become a strong competitor in trade, exerting a pronounced influence on the general
trend of world prices, it is increasingly important for the United States, as I have already indicated, to take into account what happens in Europe. There are indeed many reasons why increasingly closer contact should be established between the two sides of the Atlantic: Western Europe, on the one hand, and the United States and Canada, on the other. At the time of Marshall aid there was established the Organization for European Economic Cooperation, which was based in Paris, and in this organization the United States and Canada participated as associate members. On the initiative of Mr. C. Douglas Dillon it was proposed in the autumn of 1959 to reorganize the OEEC in order to bring the United States and Canada more fully into the picture; and in the first half of 1960 the "Group of Four"—under the chairmanship of Mr. Randolph Burgess, the U.S. Ambassador to NATO—considered this problem and put forward the proposal that the OEEC should be transformed into an organization to be called the "Organization for Economic Cooperation and Development"—the OECD—in which the United States and Canada should become full participating members. I sincerely hope that this proposal will lead to positive results, perhaps with greater attention to trade than the Group of Four had in mind.

One of the functions of the OECD will be to act in the provision of aid to countries both inside and outside Europe. It seems to me that it is only right and proper that the European countries should now be prepared to make a greater contribution to the resources needed by underdeveloped countries. At the moment there is a strong boom in Western Europe, with great opportunities for the investment of capital within Europe, but it seems likely that before long the Western European countries will once again become important sources of capital for use in other parts of the world, over and above their own needs. This expectation is based on the growth of income in Europe and the resulting greater capacity to save, with the foreseeable trend of population increase in Europe, compared with the position in other continents. It is the forecast of the experts that over the next 40 years the annual increase in population in Western Europe is likely to be at the rate of about 0.7 per cent, while the corresponding rate of increase in other continents will be nearly 2 per cent; in Asia it will be as high as 2 1/4 per cent, and in the United States it is expected to be something like 1.4 per
cent. Since a growing population requires large investments in houses, shops, hospitals, schools, and all kinds of tools and equipment, the fact that the annual rate of increase in Europe will be about the same as it has been over the last hundred years—maybe even somewhat lower—makes it likely that Western Europe will once again be able to export capital after having provided fully for its own requirements. But this export of capital should be carefully coordinated. Coordination may be achieved through direct contact between issuing houses and other lending institutions, but necessarily there will have to be greater contact between official institutions as well.

A difficult problem which is beginning to arise is the extent to which the underdeveloped countries can continue to borrow without impairing their creditworthiness. This, too, is a problem which must be considered jointly by the developed and less developed countries. International organizations may not always be able to do all that one might want them to do, but they can be of great help in many situations, and there will—and I stress it again—be need for contact both between private institutions and official organizations.

There are many other specific questions in connection with participation in assistance to the less developed countries which would be interesting to examine here, but time is short and I must try to tackle some of the very important problems relating to the value of the dollar in the foreign exchange markets, and to the evolution of the U.S. balance of payments.

The Dollar and Other Currencies

After the upheaval of a world war it takes some time before currencies are brought into proper relation one to another. So it was after World War I, when the stabilization efforts of the 1920's ended in failure. When the devaluations came in the early 1930's it was as if a time bomb, with delayed effect, had exploded, and it was soon evident that the work of establishing orderly monetary conditions had to be done all over again. This work had not been completed before World War II started in 1939, which in itself created a mass of new problems. In the 15 years that have passed since the war ended, there have been many critical periods and
devaluations in the exchange markets—some of them as recently as 1956 and 1957, connected largely with the Suez crisis. Although we had, at the end of 1958, the establishment of external convertibility by 14 European countries, we still have to ask ourselves whether we have yet reached a position of lasting equilibrium between the main currencies, i.e., between the U.S. and Canadian dollar and the various currencies of Western Europe. You will remember that at the time of Marshall aid many people spoke about a "structural dollar shortage," meaning that the United States was so efficient in its production that European countries would normally expect to have a deficit in their balance of payments with the United States. Personally I never believed in that kind of dollar shortage; I never used the words "dollar shortage" in the reports of the Bank for International Settlements, for the preparation of which I was mainly responsible, nor in any of my many articles—except once or twice when I put those words in quotation marks, making it clear that in my opinion the whole concept was faulty. It seemed to me, and to many of my friends, pretty certain that once the European countries had managed to stabilize their internal currency positions by working off the excessive liquidity remaining after the war, and taken steps to avoid any further excessive credit creation, their balance of payments could again be in equilibrium.

Let us go back for a moment to the years 1956 to 1957. In the autumn of 1956 there was the Suez crisis, with a run on sterling which threatened to become very serious. Great Britain then obtained from the Fund a combined drawing and stand-by arrangement of $1,300 million, and from the Export-Import Bank a loan of $500 million, to help it to meet the strain. The Fund credit was arranged within 11 days after the request was received, which shows that the Fund can act promptly. In the early months of 1957 it looked as if things would go well, especially since the Suez Canal was cleared quicker than at one time had been feared. But then came rumors about the revaluation of the German mark, which introduced a period of great uncertainty. However, the proper steps were taken; in September 1957 the Bank of England put up the bank rate to 7 per cent, which definitely brought to a halt what had been called the "cheap money forever" period; the German central bank at the same time lowered its rate by one half per cent, in response to the increase in the German reserves. At the Fund Meet-
ing immediately afterwards, declarations were made that the existing exchange parities would be maintained—and these declarations were believed. Experience has shown that declarations are no good if they are not combined with the proper measures, but if such measures are taken, declarations can be very helpful.

In the following winter, France elaborated and put into effect a stabilization program, also with assistance from the Fund, and with the appointment of de Gaulle as Prime Minister and then President, the position was fairly soon consolidated. De Gaulle wanted to restore the esteem of France, and he knew that no country could really be esteemed as long as it had a weak currency that had to be supported time and again by outside help. During 1958 the whole European currency situation improved, and at the end of that year came the introduction of external convertibility. This monetary improvement reflected the basic economic improvement. European industries were again in working order and were again able to deliver promptly. That had an effect on U.S. trade. Up to that time, with European industry really unable to compete effectively, American industry had had it, so to say, “all its own way” both at home and abroad. Now it was different, and it so happened that this change coincided with a recession in the United States, and with a budget deficit of $12.5 billion and a substantial creation of new credit. The result was what might have been expected: over-all deficits in the balance of payments amounting to $3.4 billion in 1958 and $3.7 billion in 1959.

In October 1958 the Governors of the International Monetary Fund and the International Bank for Reconstruction and Development had met in New Delhi, and at this meeting the U.S. Delegation included the Secretary of the Treasury, Mr. Robert B. Anderson, and also the Chairman of the Federal Reserve Board, Mr. William McChesney Martin. In the course of that meeting the delegates from a number of European and other countries expressed their fears about the dollar both to Mr. Anderson and to Mr. Martin. Mr. Anderson mentioned later on in a speech in Chicago that delegates from no less than 32 countries mentioned to him their apprehensions about the dollar. It is no secret that both Mr. Anderson and Mr. Martin were surprised to find how widespread was the lack of the confidence in the dollar, and this was bound to impress them, particularly when they considered the large foreign
holdings of dollar balances, which then amounted to some $14 billion. It was obviously a serious matter. Mr. Anderson and Mr. Martin became convinced that U.S. policy had to be changed: the budget deficit would have to be eliminated and there would have to be no more credit creation for a time. They were helped in carrying out these new policies by the fact that the business trend began to turn upward in the United States, so that the change in policy was required not only for external but also for domestic reasons. As you know, the budget for 1959/60 is likely to show a small surplus and the money supply has been kept from rising. In May 1960 the money supply was in fact somewhat lower than it had been a year earlier, which is in itself an indication of the determined steps that had been taken. I want to express my admiration for the clear-sightedness with which the U.S. situation was judged, and for the policies which were designed to meet this situation, to say nothing of the resoluteness with which those policies were carried out.

The change thus made in U.S. policies had an almost immediate effect on the state of confidence abroad. Most European countries had found that when they had taken steps to balance the budget and to apply credit restraint, their balance of payments position had improved pretty rapidly, and they expected similar results in the United States. Since the autumn of 1958 there has indeed been a distinct improvement in the U.S. balance of trade. Exports have risen more than imports, and this improvement has continued in the first half of 1960. While in the second quarter of 1959, the balance of payments deficit was at the rate of $5 billion a year, it had by the spring of 1960 gone down to one half of that figure, and there are reasons to think that this improvement will continue. It may be that short-term funds will move to other markets in response to higher interest rates, so that the outflow of funds will not come to an early end, but it is more important that the improvement on current account is likely to continue, with the high rate of expansion in Europe helping to attract imports from the United States. U.S. exports to Europe have indeed shown a marked tendency to increase.

If we look generally at the foreign exchange situation in the world, we see that the United States has still to solve a number of problems in order to reach equilibrium in its over-all balance of pay-
ments position, and that, at the other end of the scale, the Federal Republic of Germany has a strong balance of payments surplus—so strong that there is again talk about the need for a revaluation of the mark. In my opinion such a move would be a mistake, and I feel sure that it will not happen. The note circulation is expanding in Germany under conditions of booming business; wages are rising; and forces are thus operating which will tend to bring about a new equilibrium. In fact, with opposite policies being pursued on the two sides of the Atlantic—the holding down in the money supply in the United States and the increase in the money supply in Germany—I feel that the present exchange rate structure will be consolidated to the benefit of orderly development, including a continued expansion of world trade.

May I add a few words about Germany. It is true that it is not easy at the moment to establish an altogether satisfactory credit policy in that country, since whatever steps are taken have their disadvantages from either an internal or an external point of view. But credit policies are in this respect akin to other policies: it is not as a rule easy to find measures that are satisfactory from every point of view. In each situation the authorities must determine what is the main objective to be pursued; and in the Federal Republic of Germany the main thing after two inflations has been to restore confidence. "Confidence is a plant of slow growth in an aged bosom," said William Pitt: and the German experience has been two disastrous inflations. If the German authorities were now to decide to move in one direction by appreciating the value of the mark, it might be possible for them to move at a later date in the opposite direction and devalue the mark—a possibility that would not escape the suspicious German public. If the German wage and price structure were very much out of line, and were likely to remain out of line, one might begin to question the advisability of maintaining the present parity for the mark, but the gap has been narrowing in recent years and continues to narrow. Germany is still in a difficult political situation, and needs all the confidence in its currency that it can get. At the same time, Germany must be willing, by increased foreign aid, to do all it can to reduce the increase in its reserves, for even if the general liquidity position of the world is not at the moment gravely threatened, the large surplus if it persisted could have very undesirable consequences.
Capital Movements

I mention political difficulties, which usually have serious repercussions on economic life, but so far even the troubles of these recent months have not really had any disturbing effect on the world’s economic and financial affairs. It seems that all the talk about an intensification of the cold war has had practically no influence on business, which seems to be carrying on unperturbed by politics. In fact, if a war were to break out, the very gravity of the situation would make no place safe, and so there is little use in moving funds from one market to another for this particular reason. As a result there have been hardly any movements of “hot money” of the kind that so much plagued the world in the period between the two wars; the movements that have taken place have largely resulted from a shifting of funds held at commercial banks when higher returns were available elsewhere; thus some international business firms have borrowed funds in markets with low rates, and others have transferred their liquid reserves as far as they conveniently could to markets with high rates. And in spite of the failure of the Summit Conference, which of course greatly affected the position of Berlin and the Federal Republic of Germany, there has been a considerable inflow of funds into the German market, evidently without any consideration being paid to possible political complications.

Although funds will up to a point move in response to differential interest rates, I can certainly see no signs of any massive movement of funds from the U.S. market. I have been asked for many years, however, what might be the result if interest rates were to be reduced in the United States in a period of recession, while rates remained high or were even increased in Europe. I have replied that there probably would be an outflow of funds, although the central banks would not appreciably reduce, and might even increase, their dollar balances. At the same time it was, however, likely that in such a situation the current account of the U.S. balance of payments would be strengthened by increased exports to Europe. That is exactly the position today, and for my own part I feel that the improvement on the current account is more important than the movements of short-term balances. In the longer run, too, I think it is likely that interest rates in Europe will be as low or even lower than in the United States. My main reason
for believing this is the lower rate of increase in population in Europe, which will mean that the domestic demand for capital will probably be less.

What is wanted is a continuation of gradual improvement in the U.S. balance of payments of the kind that has occurred over the last six months or year. Confidence that this will continue has been strengthened by the knowledge that prices have not risen much for nearly two years—wholesale prices hardly at all and the cost of living only a little. The small increase in the cost of living has mainly resulted from increases in the cost of services, which lagged behind in the earlier period of inflation. . . . I think people in the United States, and elsewhere, have suddenly come to realize that a new era has begun—an era of more stable prices. It seems to me that for several months I have not seen any reference in the newspapers or in speeches or articles to creeping inflation, which represents quite a change. What has happened on the stock exchanges in the United States this year is, I think, a sign of the change in attitude, connected with the feeling that there is no longer any great need to hedge against inflation, as had been the case up to the late autumn of last year.

If it is true that inflation is more or less over, as I believe it is, we are faced with a new situation which brings its own problems.

Living Without Inflation

After 20 years of rising prices, businessmen and labor union leaders have got used to more or less creeping inflation; now they have to learn how to live without inflation. More attention has, for instance, to be paid to costs of all sorts. Businessmen have to consider more carefully the question of increases in money wages, which before could without any great difficulty be passed on to the consumer in higher prices; they have to realize that profit margins may be shrinking; and that credits have to be repaid in as good money as was obtained when the amounts were borrowed. All this is not easy. But the important thing is that further price increases should be avoided, for if that is not the case businessmen may easily find that they have priced themselves out of the market. When prices cannot be raised any longer, unwarranted wage increases may lead to the curtailment of production, and thus unemployment.
It is important that these dangers should be fully realized. When I have been asked why I have repeated so often that in my opinion the postwar inflation has very likely come to an end, I have replied that I do it for two reasons. In the first place, because I think it is true, and that is important in itself. But there is also another reason. Now that governments, by balancing their budgets, and central banks, by policies of credit restraint, are doing what they can to arrest inflation, it is up to the business community to play its part by resisting cost increases and holding prices down. I know of no way of making businessmen realize what the new situation requires except by telling them that they can no longer count on being able to raise their prices because of the strong competition that prevails in the markets. Something similar applies to countries: they must understand that if they inflate they will not again be saved by inflation elsewhere.

Therefore the end of inflation is not a time for complacency, but should be regarded as a new test; I think that this is being more widely realized, and many now have reason to feel that in this new situation there is great need for circumspection...

As far as the U.S. economy is concerned, the period of hesitancy has produced a slackening in business activity and a lowering of interest rates. But the volume of business is still high, and is likely to remain so I believe, thanks to three main influences: consumer demand—which is not likely to decline much, if at all; the weight of money helping to keep up the value of capital assets; and the rising level of exports, greatly helped by the strong demand from booming Europe.

In a period in which there has been much uncertainty in the field of international politics, there has recently been particularly little to cheer men's minds. But much progress has been made in the economic and financial field. We have managed to bring about a high degree of price stability to replace the postwar inflation. The most important currencies are externally convertible, and world trade is almost all paid for in convertible currencies. Discrimination in trade has largely disappeared, and quantitative restrictions are being eliminated. How different the picture was only a few years ago after the Suez crisis. Then we looked with satisfaction on a few good currencies; now we worry about those that still remain weak. This is rather like a person learning how to play golf. At
first he is very happy when he makes a few good strokes, and tells his wife about them. Then, as he becomes better and better, he takes his good strokes for granted, but remembers and worries about the few bad strokes he makes in a round. So it is with currencies now.

World trade is increasing in volume—it will probably be at least 10 per cent higher in 1960 than it was last year. Although some countries are adding greatly to their gold and dollar reserves, there is not much strain on the international financial structure. Moreover, the increase in the resources of the International Monetary Fund by $5 billion in the last year, of which about $1 1/4 billion was paid in gold, has greatly increased the “second line of reserves” available to member countries.

As regards assistance to underdeveloped countries, I think it is becoming understood that in this field there must be “a balance of responsibilities” between the richer and the poorer countries. The richer countries must see to it that sufficient development capital is made available, and they must be prepared to import the products of the underdeveloped countries without putting heavy obstacles in the way in the form of tariffs, quotas, or demand-depressing excise duties. On their part, the underdeveloped countries must ensure that the resources received are used in the most effective way. In this respect, international institutions can, as I have indicated, play a valuable role. When the Bretton Woods institutions were set up there was at first a certain suspicion of them in the commercial banking world, but I think the feeling of distrust has now disappeared. It is realized that the official institutions do not compete with the banks in any way, but there is a growing need for cooperation between them. In fact, the banking world, not least in the United States, is now taking a great interest in the work both of the International Monetary Fund and of the International Bank. It is in the interest of the United States that other countries, too, should be brought more fully into the work of international assistance on a multilateral basis. The change in the world situation has made it essential that close cooperation should be established between the two sides of the Atlantic—and it is such cooperation that holds out one of the best hopes for the free world.
Problems of 1960 *

In an interesting statement on the world economic situation presented in advance to the Council, the Secretary-General said that the General Agreement on Tariffs and Trade has much to its credit in the achievement of a multilateral reduction of tariffs, and that the International Monetary Fund has similarly contributed toward freeing most of world trade from arbitrary exchange restrictions and discrimination. It is indeed a matter of great satisfaction that at a time of many political and other difficulties so much progress has been made in the field of international trade and payments. No doubt international institutions and other sources of assistance have contributed to these satisfactory results, but the chief merit belongs to the individual governments, which, with great determination, have devoted themselves to the task of achieving monetary rehabilitation and the freeing of trade, and often have done so in the face of considerable difficulties. Although their currencies may still sometimes be subject to strain, the great majority of countries are no longer giving way under inflationary pressures. They have managed to establish a high degree of monetary confidence—a confidence which is evidenced in the domestic field by an increased flow of genuine savings, and, internationally, by a greater supply of foreign commercial credit.

As a result of the establishment of external convertibility by 14 European countries at the end of 1958 and the similar steps taken afterward by several other countries, almost all international trade is now conducted in convertible currencies. Therefore, countries can now use almost all their export receipts for purchases in any country and hence in the most favorable markets. In this situation, there are no longer any payments reasons for discrimination against imports from any particular country on the grounds of a shortage of that country’s currency. In the last year or two, the removal of discrimination has been widespread. But even more decisive steps

* Speech before the UN Economic and Social Council, Geneva, Switzerland, July 12, 1960.
have been taken recently by many countries when they declared that they no longer claim any balance of payments justification for the maintenance of restrictions, and have gone on, as many have now done, to remove quantitative restrictions on imports. This is all to the good, and gives great hope for further progress in the expansion of multilateral trade in the years ahead. With new trading groups being formed in various parts of the world, the restoration of currency convertibility and the resulting simplification of the pattern of world payments are of particularly great advantage in that a commercially somewhat complicated situation is not further complicated by currency difficulties.

The great progress that has been made in the field of international trade and payments could not have been achieved if the countries themselves had not taken the measures needed to establish a sufficient degree of internal balance in their economies. For in each country the external strength of the currency is a reflection of the balance in its internal position. Not only has the excessive liquidity which plagued so many countries in the years after the War been largely absorbed, but steps have been taken to prevent any return of excessive liquidity by the pursuit of proper budget and credit policies. Every effort is thus being made to ensure that investment will be financed by genuine savings.

In this re-establishment of monetary order, the International Monetary Fund has been able to assist many member countries. The cooperation of the Fund has been requested not only because the Fund is able to extend financial assistance, but also because these countries have wished to obtain technical assistance from an objective, international institution. The assistance has, in a number of cases, involved the elaboration of a stabilization program. Success in these stabilization efforts can be obtained only if the authorities themselves wholeheartedly believe in the value and effectiveness of the measures which have to be taken, and if they have the necessary determination to ensure the proper execution of the program.

Significance of Stabilization Plans

The authorities in many countries have shown this determination and have persisted in their efforts, even in the face of great difficul-
ties and sometimes fierce criticism. Those who are critical of the steps that have been taken have often been able to point out that the introduction of a stabilization program has been accompanied by a slowing down in economic expansion. This, it must be admitted, has often been the case, and it deserves some comment and explanation.

In practice, the gold and foreign exchange reserves of a country suffering from inflation almost inevitably decline, for reserves are used to maintain a higher rate of investment than could be financed from noninflationary sources in the form of domestic savings and foreign capital. But obviously there is a limit to the use of reserves in this way, and if a stabilization program is adopted, one of the features of that program must be to stop the drain on reserves and to begin their replenishment. That can be done only if part of the country's savings is devoted to the task of rebuilding the reserves, and so, in effect, is invested in foreign exchange. Clearly, these savings cannot then be invested at the same time in bricks and mortar. Perhaps restored confidence at home will bring about some repatriation of capital from abroad, but a fair part of the capital thus repatriated should also, at least at first, be earmarked for strengthening reserves. Theoretically, it is possible to envisage other sources of development finance (through higher taxes, cuts in current government expenditure, or increased foreign assistance), but these will not be arranged easily in practice. Therefore, a successful stabilization effort must usually mean that for a time less resources are available for development purposes.

There is at the same time another influence having somewhat similar effects. When an economy has been tuned for years to continuously rising prices, the conditions for more normal, non-inflationary business activity cannot be established all at once or without transitional difficulties and delays. When the upward surge in prices comes to an end, there will usually be a period of uncertainty and hesitancy while businessmen and the public generally get used to the idea of more stable prices—and, in addition, the necessary adjustment will lead to certain delays in the resumption of activity.

This period of slower economic expansion should be a passing phase. The return to stability is intended to provide—and generally
has provided—a reliable basis for sustained economic growth. For many reasons, the resumption of activity is easier in the industrialized countries, with fully developed economic and financial structures and national incomes high enough to support both the generation of ample savings and high levels of consumption. In these countries, little more than an easing of credit conditions may be sufficient to restart expansion, especially if the general climate of world business becomes favorable for an upswing.

*Increases in Industrial Production*

In this context, I should perhaps draw attention to the remarkable increase in industrial production in Western Europe and Japan, which was some 12 per cent higher in the first quarter of 1960 than in the corresponding quarter of the preceding year. This expansion has been accompanied by a most impressive increase in international trade that has benefited all parts of the world. In this period, the imports of Japan and the industrialized countries in Western Europe increased by 30 per cent, with imports from the United States up 50 per cent, trade with one another up 30 per cent, and imports from the rest of the world up 23 per cent. These industrialized countries now face the problem of preventing an excessive strain on their resources, and once again the authorities are relying primarily on monetary measures, including quite sharp increases in official discount rates. It may be that the high interest rate structure in Western Europe, which is a sign of the intense domestic demand for capital, is viewed with a certain apprehension by some other countries; but they should remember the interest that they have in the maintenance of activity in the highly industrialized countries on a sound basis, for they would lose far more from any sharp setback in economic activity which might follow an unrestrained boom.

In the United States, the situation is at the moment somewhat different from that in the other industrialized countries—and a certain hesitation is noticeable that is probably not unconnected with a change from an inflationary psychology to the expectation of more stable prices. But, even so, business activity in the United States has continued at a high level, sustained by the continued strength of domestic consumer demand, by the weight of money in the market in the form of funds seeking investment, and by increased
demand from abroad—especially from Europe. Since the autumn of 1959, U.S. exports have increased markedly, with the result that there has been a substantial improvement in the current account of the U.S. balance of payments.

Of the aggregate national income of all the countries that are members of the International Monetary Fund, the share of the most industrialized countries, the United States, Western Europe, and Japan, is about 75 per cent, while their share of total population is only about 25 per cent. Thus, the share of national income of the primary producing countries is 25 per cent, and their share of population is about 75 per cent. This disparity can be effectively reduced only by further growth of the economies of both these groups—leading to an expansion in their mutual trade and closer relations generally. While the recent increase of business activity in the industrialized countries has not appreciably improved the terms of trade of the primary producing countries, the substantial increase in the volume of imports of the industrialized countries has helped to increase the foreign exchange receipts of the primary producers. In this way, both groups have benefited from the expansion of trade. From a monetary point of view, this recent expansion of international trade certainly came at an opportune moment. Many less developed countries have introduced stabilization programs in recent years, and have shown great determination in executing them: the improvement in foreign exchange earnings has been of great help to most of the primary producers and has given them encouragement for further efforts.

Price Stability

In every country that attempts to stabilize its economy, credit expansion must be kept within proper limits, and at a rate not in excess, broadly speaking, of the increase in the national product at stable prices. I deliberately said "stable prices," for I believe that the postwar inflation has come to an end, and that the price stability which has now prevailed for two years in world markets will not be upset by any new general inflationary upsurge. It has become more and more evident that there is at present an ample supply of almost all commodities, not only of foodstuffs and fuel, but also of industrial raw materials and of manufactured goods, and these have all to be sold under increasingly competitive conditions.
Coupled with this, the authorities in most countries seem more and more prepared to apply in case of need strict fiscal and credit policies. In this new situation, those who fare best are those who learn most effectively and most quickly how to live without inflation.

It is important to realize that economic growth can occur under a great variety of conditions. For instance, there was a high rate of growth from 1873 to 1895 in both the United States and Sweden—two countries for which satisfactory statistics are available for that period—although at the time prices were on average slowly falling. There was a period of growth in most countries in the 1920's when prices were stable; and there was growth after World War II with rising prices. In each of these periods, business attitudes and practices had to be adjusted to the prevailing trend, but when that was done a high rate of growth was possible, and was achieved. No doubt, in the future, public policy will aim at the prevention of both inflation and deflation, but already the prospect of a more stable general price level has made necessary a greater attention to costs and a more selective granting of credit than was needed even under conditions of creeping inflation.

In underdeveloped countries with a limited volume of domestic savings and often inadequate institutions for channeling what savings there are into suitable investment, there is a strong temptation to rely on credit creation to finance development; but an excessive use of this method of financing will, today more than ever, inevitably cause grave problems, such as rising domestic prices, reduced reserves, and usually a depreciating exchange rate. Experience shows that, in the absence of monetary stability, economic incentives tend to direct investment largely into speculative ventures with prospects of quick profits instead of into projects with benefits accruing to the whole community over many years.

In addition to the distortion of domestic prices, the loss of reserves and the depreciating exchange rate have, in many cases, led to the distortion of the foreign exchange structure by the introduction of multiple exchange rates. Much harm is done by such rates in encouraging uneconomic production and investment, and in discouraging production in lines for which the country is entirely fitted. It has therefore been found essential to revert to a unitary exchange rate at a realistic level as part of an effective stabilization program.
All this, I think, is becoming fully appreciated—at least, that is
the impression we in the Fund have gained in the course of our
work. In a world in which most countries have stabilized their
currencies, there is no place for the opposite policy of continuing
inflation. But in this new situation effective measures must be
found to secure economic expansion under conditions of relatively
stable prices; and in underdeveloped countries this will generally
require resolute action to increase productivity and savings. How-
ever successful these countries may be in achieving this, they will
also need to obtain assistance from abroad. Between the countries
which provide assistance and those which receive it, there must be
a balance of responsibilities.

Responsibilities of Richer Countries

The most obvious form of assistance from the richer industrial
countries is the provision of additional capital resources to the
underdeveloped countries. It would be a mistake to think only
in terms of official capital; investment of private capital is most
important, for it is often combined with the specific provision of
technical knowledge of a continuing character. A country which
provides financial assistance must raise the amounts involved in its
own currency and must have the appropriate institutions to make
the funds available, such as, in the United States, the Development
Loan Fund, the Export-Import Bank, and other agencies; in the
United Kingdom, the Export Credit Guarantee Department; and, in
Germany, the Kreditanstalt für Wiederaufbau. The setting aside
of, say, 1 per cent of national income for the purpose of foreign
assistance through the appropriate institutions would mean that
each individual country would forego some of its own consumption
or investment in order to devote a part of its resources to foreign
assistance.

Secondly, the richer countries must see to it that they provide
adequate earning opportunities for the poorer countries; they can
do so by pursuing more liberal trade policies and by making every
effort to maintain a high level of business activity in their own
economies. Naturally, the maintenance of a high level of business
activity is eminently in the interest of the richer countries them-
selves, but the adoption of more liberal trade policies is not always
understood to be equally in their own self-interest.
Thus in trade matters much remains to be done. It is to be hoped that the tariff reductions now being taken or considered by trade groups in various parts of the world will be widened as far as possible so as to improve the prospects for the sustained growth of world trade, which would be in the true interests of the community of nations.

Thirdly, it is important to provide facilities for the technical and administrative training of persons from the underdeveloped countries. It is not a question only of granting scholarships, but of letting persons from these countries work in factories and offices where they can get acquainted with the daily run of business, industry, and public administration.

**Tasks of Less Developed Countries**

The primary responsibility of the underdeveloped countries in their present situation is to ensure that the resources at their disposal are put to the best possible use. This raises questions of technique, of methods of financing, of the balance between government undertakings and private enterprise, and, in some cases, of the whole economic and financial organization of their countries. I have already referred to the importance of monetary stability to avoid a misuse of resources. Such stability is also important for the maintenance of confidence and creditworthiness at home and abroad, which are in themselves assets of great value. Closely related is the ability to attract capital from abroad, which depends so much on the fair treatment of foreigners.

In many of the less developed countries, stabilization programs have been introduced only comparatively recently, and the full beneficial effects have not yet been achieved, although there have been encouraging signs almost everywhere. There are, however, some countries, for example, Chile, Finland, and Mexico, which have been able to stage quite an impressive increase in production. In some others, foreign exchange reserves have risen appreciably and have created a new basis for development in the years ahead, conspicuous examples being Argentina, Colombia, and Spain.

It is in the nature of things that political considerations may affect the extension of foreign assistance or the formation of trade policies.
Sometimes these considerations facilitate the finding of a solution; sometimes, however, they are a cause of obstruction and delay. After World War I, when the League of Nations undertook the financial reconstruction of Austria, Hungary, and certain other countries, several political questions arose. It was then said that the best way to deal with these matters was to try to reduce the political problems to technical problems—and it is very remarkable how often the difficulties were overcome in this way. In the same way, the more often problems can be attacked on a technical plane, both in the United Nations and the specialized agencies, the more readily will the stumbling blocks that would otherwise impede the expansion of production and trade be removed, and the more readily will agreed solutions be reached.
Annual Report, 1960 *

Looking around the world today, it is not surprising that many people take a sombre view of the widespread social and political unrest and the serious problems to be solved. It is thus most satisfactory that there are so many signs of continued progress in the economic and monetary fields, where in many respects developments have been distinctly favorable. In a great many countries investment has been at a high level, and the volume of production has been generally rising—often at a rapid pace—while there has been a conspicuous expansion of world trade, which has now continued for nearly two years. Because of the increased supplies of both primary and manufactured products, and the cautious fiscal and credit policies pursued, the boom conditions which have prevailed in many countries have not led to a resumption of inflation but have been accompanied by a high degree of price stability. The expansion of world trade, which originated in the industrial countries, has also had beneficial effects for many of the primary producing countries, which have generally found it easier to dispose of their products and to improve their payments position. It is true, of course, that for many of the less developed countries—which are as a rule the producers of raw materials—the failure of the prices of many of their products to recover has been a source of disappointment and difficulty. The Fund has maintained close contacts with these countries, and in general they have continued their efforts to restore and maintain monetary balance and to develop and diversify their economies on the basis of available resources, domestic and foreign.

While in certain countries realization has not always been up to sometimes perhaps exaggerated expectation, and strains and stresses have become noticeable as capacity limits have been reached in many of the industrial countries, fewer countries have been faced with balance of payments difficulties; consequently, there has been a reduced demand for financial assistance from the Fund. Mone-


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tary consolidation has continued, and progress has also been made in the removal of trade and payments restrictions and discrimination. It may be thought that this is painting too rosy a picture, for there are still many troublesome problems facing us, but it is worth noting how relatively well business—in the widest sense of that word—has carried on unperturbed by political events, and how the majority of countries have been able to take such difficulties as arose in their stride. This undoubtedly reflects greater economic balance and the availability of more adequate reserves.

Activities of the Fund

For the Fund itself, as is clear from the Annual Report of the Executive Directors, the past year has been constructive in many respects. The Fund has continued to hold annual Article XIV consultations and has been active in giving technical assistance to member countries, and in some cases to countries which were not yet members of the Fund. In addition, the training program has been continued on the same lines as in previous years. Altogether during the past year Fund missions have visited over 50 countries, technical advisers have been resident for varying periods in 15 countries, and participants in the training program have come from 26 countries. Throughout the Fund's consultation and technical assistance work, it has been possible to discuss fully and frankly the problems of the individual countries with the officials of those countries. A feeling of mutual confidence has been built up over the years as a result of the greater familiarity of the Fund personnel with the problems of the countries which they visit. I think it is also true to say that the officials of member countries of the Fund welcome the opportunity to examine their problems with experienced international observers.

The amount of financial assistance granted by the Fund during the last year was on a smaller scale than in the three preceding years, reflecting the improvement in the over-all monetary position, particularly in the industrial countries with larger drawing rights on the Fund.

It is the accepted practice for the Fund, in appropriate cases, to obtain from countries seeking financial assistance declarations of intent of the policies that they will follow. If a country is obliged to deviate from the policies specified in such a declaration, it normally
consults with the Fund in order to reach a new understanding on the basis of which any further drawings may be made. It has been the Fund’s experience that member countries have made great efforts to implement the programs contained in their declarations of intent and have made considerable progress toward improving their position. There can be no doubt that the progress made in recent years has created a “climate of opinion” in which the return to monetary stability, with greater freedom from restrictions, has become the order of the day. It seems, indeed, that in the monetary field both good health and sickness can be infectious.

There is naturally a difference between the amounts of financial assistance needed by a large and by a small country, but for the Fund the work involved is very much the same. The difficulties of introducing appropriate fiscal and credit policies, removing restrictions and discriminations, and simplifying complex currency practices will, of course, depend upon the circumstances of each case, but it has been our experience that small countries are beset by difficulties no less hard to surmount—and indeed often harder—than those besetting their larger neighbors. This is particularly true for the less developed primary producing countries, and nearly all Fund transactions during the past year have been with those countries whose main sources of foreign exchange come from the export of primary products.

The total resources of the Fund have been increased greatly over the past two years; with the increases in members’ quotas, initiated at the Annual Meeting in New Delhi in the autumn of 1958, the total has risen by $5.4 billion, to $14.5 billion. Only five countries have not yet accepted their quota increases, and of these it is expected that two will do so before the end of the period for acceptance, which has now been extended to October 31. In addition to the over-all increase, the Fund’s effective liquid resources have been substantially increased as a result of the moves to external convertibility, and the Fund now holds $3 billion on gold account and $7 billion in currencies which are at least externally convertible.

The total amount of currencies purchased from the Fund, and not yet repurchased, amounted on August 31, 1960 to the equivalent of $1,069 million, and the amount available to members under stand-by arrangements to the equivalent of $267 million. That the total of outstanding drawings and commitments under stand-by
arrangements is so much smaller than it has been in recent years has resulted, in a large degree, from the expiration of stand-by arrangements and accelerated repurchases from the Fund. Thus during the year, Mexico, Pakistan, and the United Kingdom did not request the renewal of their stand-by arrangements. In the same period, repurchases amounted to a total of $642 million. Some of these repurchases have been made in accordance with agreed undertakings, and would thus have fallen due in any circumstances; other repurchases have had to be made because obligations have accrued as the result of increases in monetary reserves, while others have been made voluntarily in advance of any specific undertakings or obligations. These two latter categories of repurchase once again reflect the improvement in the monetary position of member countries. For the individual country, advance repurchase means that its primary reserves are reduced, while its "second line of reserves"—consisting of possible use of the Fund's resources—is increased. From many points of view—including considerations of a more general character in connection with the flow of funds between different monetary centers—it seems preferable that a country which increases its reserves should make prompt repayments to the Fund, for the Fund would always be ready under its rules to extend renewed assistance if it should be needed.

Elimination of Discrimination

At the last Annual Meeting, two questions of a general character were discussed, and were to be considered further by the Executive Directors. On both these questions, the elimination of discrimination and the acceptance of the obligations of Article VIII, the Executive Directors agreed upon statements which were made public and which are reproduced in the Annual Report.

In their decision on discrimination, taken on October 23 last year, the Executive Directors dealt with discriminatory restrictions imposed for balance of payments reasons. They noted that there had been a substantial improvement in the reserve positions of industrial countries in particular, and that there had been widespread moves to external convertibility, and they concluded that, under these circumstances, there was no longer any balance of pay-

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1 See above, page 152.
ments justification for discrimination by members whose current receipts were largely in externally convertible currencies. It was agreed that in some countries a reasonable amount of time would be needed fully to eliminate discriminatory restrictions, and that special problems could arise for countries when a substantial portion of their current receipts was still subject to limitation on convertibility, particularly in their relations with state-trading countries.

Today, an overwhelming part of world trade is paid for in externally convertible currencies, and it is gratifying to be able to report that very substantial progress has been made in the elimination of restrictions, especially in relation to the dollar area. This is, however, a continuing process; and further measures for removal of discrimination are still needed, particularly in a number of cases where they are applied against non-dollar countries.

The Fund decision on discrimination was communicated to the CONTRACTING PARTIES to the General Agreement on Tariffs and Trade (GATT), which then issued a similar statement. In this connection, I may perhaps refer briefly to the Fund's concern with the problem of eliminating restrictions in general, whether they refer to trade or payments and whether they are discriminatory or not. In relation to the GATT, the Fund may be called upon to state whether for a given country restrictions can be justified on balance of payments grounds. Questions of this kind have been examined in connection with the annual Article XIV consultations, and in certain cases the conclusion has been reached that the country in question has no balance of payments justification for the maintenance of quantitative restrictions, and the CONTRACTING PARTIES have been informed of this. It is then up to the countries concerned to justify the retention of such restrictions on other grounds, or to remove them.

In this wider field of restrictions, substantial progress has likewise been achieved over the last year. While no single factor can be said to be the cause of the recent remarkable expansion of world trade, there can be no doubt that the progressive removal of restrictions and discrimination has played a considerable role, to the great benefit of all countries. This progress has included the liquidation of a considerable number of bilateral payments agreements. However, many such agreements remain, and to this extent there are still appreciable limitations on the ability of traders to sell and buy
freely in markets where they can find the most advantageous terms. The Fund will, of course, continue to work for the establishment of a world-wide system of multilateral trade and payments. In a number of countries, the system of restrictions reflects a position of domestic instability and consequent distortions, or is maintained because of strong protectionist pressures, but there is fortunately a growing awareness of the fact that restrictions and discriminations are harmful not only to other countries, but even more to the countries which continue to apply them.

Article VIII and Article XIV

The examination of the legal, policy, and procedural aspects connected with a member's acceptance of the obligations of Article VIII was also begun after the last Annual Meeting, and on June 1 the Executive Directors agreed upon a decision intended to serve as a guide to members in pursuance of the purposes of the Fund as set forth in Article I of the Fund Agreement.

Under the transitional arrangements of Article XIV, members are entitled to maintain and adapt restrictions on payments and transfers for current international transactions without the prior approval of the Fund. When, on the other hand, a country accepts the obligations of Article VIII, it has to obtain the approval of the Fund for any restrictions on such payments that it is maintaining at that time; and for the future it must obtain the prior approval of the Fund both for the introduction or reintroduction of restrictions and for any adaptation of existing restrictions.

It is perhaps useful to stress that, under Article XIV, countries have only the right to maintain and adapt restrictions; therefore an introduction or reintroduction of restrictions would already require the prior approval of the Fund under Article VIII, even though the country concerned has the status of Article XIV. From a more general point of view, the acceptance of all the obligations of Article VIII can be considered as the consolidation of the attainment of convertibility for current international transactions; it implies that the country making the move feels able to conduct its international financial relations without any significant use of restrictions. Therefore, for countries that have remaining restric-

footnote:
2 Annual Report, 1960, pages 29-31; Selected Decisions, pages 76-78.
tions of only limited scope, and that are not likely to need to resort to restrictive measures in the foreseeable future, the transition to Article VIII would seem now to be an appropriate step. Several countries have been carefully considering such a step, and at the Fund's request have provided detailed and comprehensive information on their exchange systems. It is therefore to be expected that several member countries will move to Article VIII in the near future.

An important feature of the decision of the Executive Directors of June 1 was to outline the methods of regular consultation with the Fund as more and more countries assume the obligations of Article VIII. The question is important because regular consultations are not mandatory for Article VIII countries, except in certain limited circumstances. The Executive Directors emphasized that the Fund is able to provide technical facilities and advice to member countries, and can provide a forum for the exchange of views on monetary and financial developments; they considered that there is great merit in periodic discussions between the Fund and its members—even though no questions arise involving action under Article VIII. The Executive Directors concluded that such discussions would be planned between the Fund and the member, including agreement on place and timing, and would ordinarily be held at intervals of about a year.

The method thus outlined for Fund contact with its members means that, in addition to the annual consultations with Article XIV countries, arrangements will in the future be made for periodic discussions with countries under Article VIII. By the voluntary acceptance of a practice that has proved so useful for both the Fund and many member countries, the Fund should be able to maintain and strengthen its bonds of contact with members and, in general, to increase its effectiveness as a center for monetary cooperation.

The principles or lines of guidance laid down in the two policy statements which have been made by the Executive Directors since the last Annual Meeting now form part of the code of good monetary and economic behavior which is gradually being evolved and adhered to by the members of the Fund.

Turning to another matter, I want to refer to the study prepared by the Fund in response to a request from the seven countries which
formed the Latin American Free Trade Association with the signing of the Treaty of Montevideo on February 18, 1960. The Fund was asked to prepare a study of the payments problems which might arise within the Association. In the study, stress was laid on the great advantages of a system of settlement in freely convertible currencies. At a meeting of central bankers of the seven countries, it was reaffirmed that the principle of free convertibility of currencies is the objective to be attained. It is therefore to be hoped that the Latin American countries concerned will regard convertibility of currencies as a condition for the successful implementation of their trading arrangements.

In the field of international monetary and commercial relations, many new organizations and institutions are being formed all over the world. In a period of rapid economic development, new institutions are certainly sometimes needed, and I would particularly like to extend a special greeting of good wishes to the newly formed Inter-American Development Bank, whose first President, Mr. Herrera, was formerly an Executive Director of the Fund.

It is, however, becoming more generally realized that a multiplication of international organizations and institutions cannot provide a panacea for all our problems, and I am reminded of an old principle of logic, dating from the Middle Ages and known, after the English philosopher, as Occam’s razor: “Entities should not be multiplied beyond necessity.”

Results of External Convertibility

As we look back over other developments, it is clear that the establishment of external convertibility has given new vigor to the working of the world’s exchange markets and to the international banking system. It is not only that nonresident holdings of the currencies of most industrial countries are now fully convertible, but also that the commercial banks themselves have more substantial foreign funds with which to operate. Partly as a result of this increased freedom, the financing of trade has been greatly facilitated, and this has certainly been one of the factors behind the expansion of world trade. At the same time, the changes have made possible the shifting of available liquid funds or the movement of trade financing from one money market to another in response to changes in relative interest rates. During the course of this year,
reflecting mainly domestic developments, short-term rates in the United States and Canada have fallen by about 2 per cent, while in Germany and the United Kingdom they have risen by some 2 per cent. A change of as much as 4 per cent per annum in the relative advantage of keeping money or financing trading operations on one side of the Atlantic rather than the other has naturally induced many business enterprises and financial institutions to review their positions in the different centers and to make adjustments in the light of the new situation. The intensification of other restraints on the availability of credit in some European countries, especially in Germany, has added to the flow of funds. On the other hand, only relatively limited movements of funds seem to have resulted from political considerations.

Movements of funds have also been due to surpluses and deficits on the current account of the balance of payments. Indeed, it is important not to lose sight of the fact that fundamental developments on the current account reflect the basic earning positions of the countries concerned.

As far as the more fundamental balance of payments position of the major trading countries is concerned, the most striking change has taken place in the United States. After a substantial surplus in 1957, the United States had a balance of payments deficit of about $3\frac{1}{2} billion in both 1958 and 1959. This deterioration was due to a combination of factors: on the one hand, the increased competitive power of the other industrial countries in world markets, and, on the other, the budget deficit and the increase in the credit volume in the United States during the 1958 recession. Once, however, the recession was over, U.S. fiscal and credit positions were reversed. The 1959-60 budget had a surplus of $1 billion; and for over a year the money supply has been kept steady. The rise in prices seems to have been arrested, and more attention is being paid to costs. In the foreign sector, exports started to rise in the autumn of 1959, partly as a result of the boom conditions in the countries of Western Europe, which so far this year have increased their purchases of U.S. goods by over 50 per cent compared with the same period of last year. There is now a substantial trade surplus, which for the whole of 1960 may exceed $4 billion and which, with net income from investments and other invisible receipts, may well amount to $6 billion. Compared with last year, this would represent an
improvement of over $3 billion, and would be sufficient to cover fully the present rate of U.S. Government expenditure abroad, including military expenditure and economic grants and loans.

This will still mean, however, that the outflow of short-term funds and the export of long-term capital on private account will have to be met by an increase in dollar liabilities or by sales of gold—which, incidentally, seem to excite public opinion far more than the fundamental condition of the balance of payments. Nevertheless, these movements—and the same is true of government loans—have as their counterpart the acquisition of foreign assets and in this way are somewhat different from an outflow of funds resulting from a deficit on current account. However, it must be borne in mind that the improvement which has occurred on the U.S. current account this year, while it is basically an important development, results from some special factors, particularly the strong boom in other industrial countries. It is, therefore, too early to conclude that the U.S. payments difficulties have been fully overcome, and continued vigilance is required.

It is interesting to note that the Fund’s operations have recently made some contribution to the dollar position. During the last 1 ½ years repurchases in U.S. dollars have amounted to nearly $700 million, while dollar drawings were only $200 million. As a result, other countries have transferred about $500 million net in U.S. dollars to the Fund, and the rate of increase in their dollar balances and gold holdings has been slowed down accordingly. The dollars received by the Fund have been returned, under the Fund’s rules, to the U.S. Treasury against the issue of noninterest-bearing demand notes to the Fund. During the coming year it is expected that repayments will continue to be made mostly in U.S. dollars, and that the proportion of other currencies drawn from the Fund will increase.

The main counterparts of the payments deficits of the United States in 1958 and 1959 were large surpluses in a number of European countries. It is not yet possible so far this year to obtain a clear picture of the basic payments developments in Europe; they have partly been obscured by movements of short-term funds. But, broadly speaking, it would seem that the tendency toward balance in the foreign account of the United States has been matched by declining surpluses in Europe.
The Federal Republic of Germany, which for several reasons has had the largest inflow of funds from abroad, poses a number of problems. The German authorities have introduced some special inducements for the maintenance of short-term funds abroad, and the Bundesbank has recently granted a loan of the equivalent of $240 million to the International Bank for Reconstruction and Development. At the same time, the Bundesbank has not, to any appreciable extent, converted its substantially increased dollar holdings into gold. These steps have been useful as far as they go, but what gives rise to concern is Germany's particularly large surplus on current account, which has averaged $1.3 billion per annum over the last three years. The question has in particular been asked whether there are corrective forces effectively at work in the present German situation. No doubt, German foreign trade is in a strong position during a period when investment goods are greatly in demand in world markets, and when, nevertheless, the prices of imported raw materials have not risen. There are, it is true, some signs of an adjustment taking place. In Germany, wage contracts negotiated in a number of important industries in July this year have incorporated a rise in wages averaging 8½ per cent, in addition to a shortening of the working week; and the note circulation has been increasing at about the same rate. Moreover, in the first seven months of 1960, imports increased by 25 per cent, compared with the same period of the previous year, while exports rose by 21 per cent. These tendencies are likely to continue and could be reinforced by further efforts to facilitate German imports. But it should not be overlooked that Germany needs a substantial surplus on current account to sustain what could be regarded as the desirable level of German capital exports. With boom conditions in Germany continuing, the high level of interest rates acts as a deterrent to private capital exports. It will, therefore, be a matter for the German authorities, assisted perhaps by private industrial and banking groups, to arrange the internal finance needed to make increased funds available to other countries by capital exports, or in other ways. This would minimize the danger of increased strain and nervousness and ensure further German participation in the provision of capital for less developed countries.

It is important that we should not allow our thinking to be dominated by the movements of short-term capital, overwhelming
as they may seem to be over a short period. The field over which realistic exchange rates prevail has been widening; and more effective support can now be provided, if need be, by increased reserves in many countries, and generally by more substantial assistance from the Fund following last year's increase in quotas. Such assistance is given for a variety of reasons, and should of course not be regarded as available merely in emergencies. We have, therefore, reasons to expect that, by and large, the present exchange structure will continue to gain in strength and cohesion.

Adequacy of Monetary Reserves

Some of us present here today will remember that the replenishment of monetary reserves was a problem after World War I, when no really satisfactory solution was reached. The same problem has had to be faced again after World War II—aggravated by the decline in reserves that occurred in the years immediately following the War. But since then, we have been more successful, partly because of the funds made available by the United States. The Western European industrial countries and Japan now possess gold and foreign exchange reserves amounting to $24 billion, compared with $8 billion at the end of 1947. Over the same period, however, the aggregate official reserves of the less developed countries actually declined. In the light of these changes, I think it is appropriate to make some observations on the subject of the adequacy of reserves.

Many attempts have been made in the past to define what should be regarded as an adequate level of reserves; and in view of the great diversity of tradition and policy in different countries, it is hardly possible to give a simple answer to the question. It is possible, however, to indicate in a few words what might be regarded as an ideal state of affairs: a country should have reserves large enough to give it a sufficient margin for the pursuit of its domestic economic and financial policies, but not so large as to free it from the necessity of having to observe a modicum of monetary discipline.

I think that individual countries, like individual business firms, can have liquid reserves which are too large. I remember that in my own country, Sweden, after World War I, there were some firms with such large reserves that in the postwar crisis they were able to postpone any adjustment of their affairs when the business situa-
tion became more difficult; other firms with smaller reserves, which were obliged to make the required adjustments more quickly, as a rule fared better in the long run. For a country, however, the magnitude of the reserves that are needed will in fact depend very much on what policies are pursued, and those countries which wisely adjust their policies to changing situations can do with smaller reserves. This is, of course, not a new experience, for, to quote from the Book of Proverbs, "How much better is it to get wisdom than gold! and . . . understanding rather to be chosen than silver!" It is, of course, preferable to have both wisdom and sufficient reserves, but without wisdom and proper policies, no level of reserves will suffice.

It is my belief that the majority of the larger industrial countries, which exert the more decisive influence on the trend of world affairs, have adequate, or very nearly adequate, reserves. This, of course, presupposes that these countries will succeed, as I believe they can succeed, through their individual efforts and concerted policies, in preventing any marked tendency toward either inflation or deflation at home and in the world price level generally. Such replenishment of reserves as may still be needed by countries in this group can be met, I think, without difficulty from current supplies of newly mined gold and a moderate expansion of foreign exchange liabilities.

If thus the true purpose of reserves is to allow proper domestic policies to be pursued, with changes in reserves giving useful warning signals, there arises the question of what are the proper domestic policies to pursue. Probably the most simple answer is that the policies should be designed to help to create conditions under which there can be sustained domestic expansion. With this purpose in view, a number of countries have declared that such credit measures as they have recently taken have been determined "predominantly by domestic considerations." In some countries, the measures taken involved credit restraint to prevent excesses in a boom; in others, the introduction of greater ease to promote activity in a period of slacker business. But "predominantly" must clearly be taken to mean that other considerations have not been forgotten; it would indeed be shortsighted to neglect them, even in relation to the main domestic purpose of sustained expansion. If, in an attempt to raise activity by credit and fiscal policies, inflationary pressures are set up, the resulting cost and price increases
and weakness in the external balance may soon create conditions under which economic expansion could not be maintained. Conversely, persistent strength on foreign account and the building up of unnecessary reserves may easily involve a misuse of a country's resources, for which a better employment could be found.

As I have already discussed in connection with the current situation, special difficulties may arise from sudden shifts in commercial financing, or, more generally, from an outflow of short-term funds. In ordinary times, therefore, reserves should also be sufficient to make it possible for countries to take such changes in their stride. And in this connection, the second line of reserves available to countries through the Fund remains an important factor.

Less Developed Countries

In considering the problems of the less industrialized countries, it is interesting to note that some of them—notably Argentina, Colombia, Israel, Malaya, Morocco, Peru, and the Sudan—have succeeded in increasing their gold and foreign exchange reserves quite considerably over the last year. But for the general run of these countries, the picture is different. For many of them, reserves are clearly on the low side—and in some cases embarrassingly low. Measures taken to strengthen their reserve positions would without doubt be of great advantage to them. It will generally be impossible to achieve any spectacular increase, but a more or less regular addition to reserves would have beneficial effects both internally and externally. Such an increase, by deliberate policy, would provide an increasingly reliable basis for the accumulation of savings and for economic growth, and would help to improve the country's creditworthiness abroad, especially if a policy of fair treatment for foreign investments is pursued.

An increase in reserves, however, is a type of investment for which genuine savings, from domestic or foreign sources, are required; and if those savings are used to accumulate foreign reserves, they cannot be used for other investments, in plant or equipment, houses, harbors, or roads, in the domestic economy. Usually a replenishment of reserves requires a moderation in internal spending, and often a temporary slowing down in the rate of growth. This usually presents certain difficulties for the less developed countries, devoted as they are to the promotion of invest-
ment; as a result, few resources are as a rule made available by them for the replenishment of their reserves. In those countries where investment plans are drawn up for some years to come, it is therefore particularly important that due weight should be given to the requirements of the reserve position, and that resources should be set aside for the building up of reserves as one of the objectives of the plan....

One of the particular problems facing the less developed countries has been the general weakness of the prices of many of their main export products. The Fund was therefore asked by the UN Commission on International Commodity Trade to present a study of its policies and procedures in relation to the compensatory financing of commodity fluctuations; in this study the Fund made it clear in what circumstances it would be able to assist countries in overcoming temporary payments difficulties arising from fluctuations in the prices of export products. Such assistance may undoubtedly be valuable, but it cannot in itself affect earning possibilities, as determined by the relation of demand and supply in world markets. A possible solution has been sought in international commodity agreements that involve among other measures the limitation of supplies. This may be feasible for some—though certainly not for all—commodities. But in the long run the only really effective influence on market prices will come from a high and rising level of activity in both the industrial and the less developed countries. For certain commodities in particular, this increase in demand could be encouraged by a lowering of obstacles to international trade and a reduction in demand-depressing excise levies. While the industrial countries have obviously a predominant role to play in encouraging demand, attention should also be paid to the possibilities of increased trade between the less developed countries themselves, which is often hampered by self-defeating import restrictions.

For many of the primary producing countries, one of the main hopes lies in the diversification of production. Here, of course, capital and technical knowledge are needed, and in this respect the richer countries should be able to make an even greater contribution. It is not as if little or nothing has been done to promote diversification, but more can be achieved; and a quickening of the

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3 Staff Papers, Vol. VIII (1960-61), pages 1-76.
pace will surely be dependent upon the degree of confidence and cooperation that can be established between the developed and the less developed countries, and the creation of conditions which are likely to ensure a rational disposition of production and to improve the facilities for technical and administrative training.

From time to time it is necessary to take a new look at the general economic situation, either because things have turned worse or because they have improved. This time I suggest we should do so because in some essential respects there has been a substantial improvement, and at least some of the problems with which we struggled for years are now well under way to a more definite solution. In particular, I have in mind the establishment of external convertibility for many currencies, and the more convincing signs of greater price stability. These developments, of course, reflect a fundamental improvement in the world situation.

In this new situation there are certain fears which, however natural in view of past experiences, can today be easily exaggerated. In those countries which fear most of all the threat of inflation, the authorities and people can now, it seems, be assured that by the maintenance of a stable exchange rate they will not expose themselves to "imported inflation." Also fully understandable, in the light of the bitter experiences of the past, is the fear of heavy unemployment. However, in these postwar years employment has, by and large, been at a high level, and there are many stabilizing factors which now help to ensure that employment will be kept up. Nevertheless, with a more stable world price level, it is important to remember that too high a level of costs and prices will tend to limit the volume of sales and production, and thus cause unemployment.

In the private sector, now exposed to more intense competition with the halt to continuously rising prices, the need to pay more attention to costs must be part of the day's work. There may be a danger of more persistent demands for increased protection, but to accede to these demands would reduce the impetus toward highly desirable and necessary adjustments, and would also impair the expansion of world trade. The Contracting Parties to the GATT are at present meeting in Geneva to negotiate tariff reductions. It is sincerely to be hoped that at this meeting, and in the future, as much progress as possible will be made in dismantling obstacles to trade.
It has been said that it is a good thing for each generation to be faced with an important challenge. We may well think that our generation has had to face more numerous challenges than it could readily meet. But we have certainly proceeded with much determination and success in our efforts to achieve international cohesion and progress in the economic and financial field. It is no mean achievement to have almost doubled in a decade the volume of world trade, and to have established an effective international payments and credit system based on convertible currencies; and I believe we are entitled to think that at least some of the challenges have been met. Although we are still confronted with many important and difficult problems, especially in relation to the less developed countries, our resources are more ample and our methods of cooperation more developed, and there are good reasons to expect that these problems will be solved through continued individual efforts and effective international cooperation.
Gold and Balance of Payments Problems *

The subject on which I speak—"Gold and Balance of Payments Problems"—would be almost too vast a subject for a speech after a luncheon, even without all the complications with which we are faced at the moment. I have, however, one big advantage: I am speaking to a group of people who already know a great deal about balance of payments problems. Such knowledge is rare in any country—even in those European countries which have had to surmount intermittent balance of payments difficulties over many years. Knowledge of these problems is, I should think, probably rarer here in the United States, which has had to meet substantial balance of payments deficits only during the last few years. A friend of mine, whom you all know and who is here today, Mr. Allan Sproul, recently said to me that very few Americans know anything about the balance of payments, but they do get excited about the symptoms—the outflow of gold and now the price of gold—and it is just as well, he added, that they do get excited about this, for it is better that they get excited about something in this field than about nothing at all. It certainly forces people to give careful thought to the question, which I think has already been the case.

You all remember, I am sure, that only a few years ago it was, so to say, standard jargon to speak about the "structural dollar shortage," and, indeed, to imply that European and other countries could hardly ever hope to earn enough dollars to pay for their imports from the United States. There were only a few who dissented, and they generally quoted some words in an article by Lord Keynes which was posthumously published in July 1946. In this article he gave as his opinion that the high costs and high living in the United States would restore equilibrium in the rest of the world's balance of payments with this country. I have often quoted Keynes' opinion myself—and in a review of a book of mine by Dr. Thomas Balogh he derided me for the "pathetic way" in which I tried to evoke the authority of Keynes. I think I must admit that the attainment of

equilibrium took longer than either Keynes—or I—had expected, for peculiar circumstances—such as the excessive and persistent postwar liquidity and also the Suez crisis—delayed the effect of the basic corrective forces, although in the end they proved predominant. You know the famous lines of Longfellow: "Though the mills of God grind slowly, yet they grind exceeding small." I would say: "Though the trends of cost act slowly, yet they act exceeding sure."

In 1957, the year most affected by the Suez crisis, the United States had a balance of payments surplus, but by the following year there was a deficit of $3.5 billion and in 1959 one of $3.8 billion.

How was it that there was such a sudden change from 1957 to 1958? It was caused, I think, by two things. Once the difficulties of the Suez crisis were overcome—and they proved less intractable than had generally been feared—European industries, with capacity restored and considerably modernized, were able to deal promptly and efficiently with orders, and were thus able for the first time since the War to compete effectively with U.S. industries. This competition made itself felt in foreign markets—in Europe and elsewhere—and also in the U.S. home market itself. Secondly, the change resulted from the fiscal and monetary policies pursued here in the United States.

In late 1957, after the recession had begun, there emerged a deficit in the federal budget, which finally reached $12.4 billion for the fiscal year 1958/59, and there was an expansion of credit of very much the same magnitude. In a smaller country, strongly expansionary fiscal and credit policies soon lead to a "spilling-over" of purchasing power and thus have an adverse effect on the balance of payments. Personally, I hold the belief that this is very much what happened here in the United States. I think the Lord has given no dispensation to the United States from the ordinary credit principles.

The Strength of the Dollar

The U.S. authorities soon realized that doubts were beginning to be expressed about the strength of the dollar and that fears were spreading in fairly wide quarters. Obviously, steps had to be taken,
and the first thing that was done was to alter the fiscal and credit policies, and this was also desirable for internal reasons, as soon as the business trend turned upward in 1959. Indeed, in the fiscal year 1959/60 there was a surplus of over $1 billion in the federal budget; and over a period of 15 months, taken as a whole, there was no net increase in the money supply. These changes in policy have had the expected effect, but have been reinforced to some extent by the psychological change that has taken place in this country since the beginning of this year. There no longer seems to be a general expectation of a continued rise in prices, and there has not been any talk in the newspapers for many months, as far as I have seen, even about "creeping" inflation. And businessmen have shown increased concern about profit margins, which have in many cases shrunk even though gross turnover has risen.

What has been the effect on the balance of payments? Exports have risen, helped considerably by the boom in Europe, while imports have remained very much the same. As a result, the export surplus in merchandise trade this year may amount to more than $4 billion, compared with $1 billion in 1959. Net income from investments and services should come to roughly $2 billion. This total of more than $6 billion would be sufficient to cover fully the present rate of U.S. Government expenditure abroad, including expenditure for military purposes and official foreign assistance of all kinds.

But there remains an over-all deficit in the balance of payments which is likely to exceed $3 billion, resulting from private long-term investment abroad and the outflow of short-term funds, mainly to Europe, in response to the interest rate differential, which, until recently, has been about 2 per cent. These movements of funds—and the same is true of government loans—have as their counterpart the net acquisition of foreign assets, and from this point of view the deficit is perhaps less perturbing than a deficit on current account would be. However, an over-all deficit of $3 billion per annum can clearly not be allowed to continue forever. In trying to decide how and when the deficit can be eliminated or even reversed, we have to consider particularly the prospect for capital movements in the years ahead, and that will depend, among other things, upon the prospective supply and demand for capital in the United States and Europe.
International Supplies of Capital

As far as the demand for capital is concerned, it is useful to remember that we can make some kind of forecasts about population trends, which are important because a growing population requires large investments, not only for houses, hospitals, schools, and services, but also for tools and equipment. The experts tell us that over the next 40 years the annual increase in population in Western Europe will be at the rate of about 0.7 per cent, while in the United States it will be something like 1.4 per cent, and in the rest of the world, nearly 2 per cent.

Because of these trends, I think it is fair to expect that Europe will have more capital available than the United States, or indeed other areas, after meeting its own needs. It is interesting to remember that before 1914 France, with a relatively small rate of growth of population, was the main center for the issue of foreign loans.

It is therefore to be expected that fairly soon there may be a tendency for capital to flow from Europe to other continents, including the United States. The capital outflow from Europe may well take many forms: financing of international trade, repurchase of assets now owned by Americans in Europe, purchase of stock exchange securities, as well as direct investment by Europeans in the United States. There is, of course, the question of timing. How soon will this reversal set in? At present there is a construction boom in Germany, Great Britain, and in many other European countries, which absorbs much capital; but there are few who think that this boom will go on for many years to come. Once it is over, I think that the movement of capital will begin to change direction, and I believe the outflow of funds from the United States will very likely be reversed in the not-too-distant future.

I do not say this to promise immediate relief for the U.S. balance of payments; but if relatively cautious policies are continued in this country, the task of eliminating the deficit should not be too difficult or too protracted. This is one of the reasons why I am not pessimistic about the value of the dollar, provided always, of course, that sufficient care is taken.

Significance of Gold

The present gold stock of the United States is now some $18 billion, and short-term foreign liabilities—excluding those due to
international institutions, which are a kind apart—have reached about the same figure. From a banking point of view, to have 100 per cent gold backing for short-term liabilities is a very sound position. But every banker knows how embarrassing would be a loss of confidence, leading to a run on his liquid assets, even though he himself has every confidence that his position is good enough to weather any storm. It is not in the interest of those foreigners who hold short-term dollar assets, on which interest is earned, to exchange them for gold yielding no interest, and as long as the United States pursues policies which seem to them to ensure that the value of the dollar will be maintained, it will be to their advantage to maintain their dollar holdings.

The recent flurry on the gold market in London is noteworthy in this connection. As you know, for a few days the price of gold rose to over $40 per fine ounce, as compared with the official price of approximately $35. Such an increase was unfortunate because it could have provoked a psychological chain reaction engendering further distrust in the dollar, especially since it seems that at least a proportion of the buying was done on behalf of U.S. clients. I have tried, on the one hand, to make it clear that official policy will certainly not be determined by the misconceptions of speculators and, on the other hand, to point out that there is more cooperation between the monetary authorities than is generally known. The price has in fact come down to less than $36, but it is perhaps too early to say that all the "heat" is out of the market.

Questions have been asked about the financial role that the International Monetary Fund could play in this context. The U.S. Government has substantial drawing rights in the Fund, some of which it could use well-nigh automatically. But being the owner of so much gold of its own, it has preferred to rely on its own resources—which has been a well-justified display of strength.

Appropriate Credit Policies

From a more fundamental point of view, the balancing of the federal budget and the cautious credit policies of the past two years have inspired confidence; and although the recent outflow of funds on capital account has been partly converted into gold by foreign
central banks, there has been little or no reduction in the total amount of dollar balances held by other countries. But people are naturally asking the question, "What will happen if there is a recession in the United States, leading to a deficit in the budget and the pursuit of an easy money policy?" As you all know, this question has been asked more pointedly during the recent election campaign, but I can assure you that people were wondering about it long before the summer and autumn of this year.

In the present period of some relaxation of business activity, it might perhaps be helpful to repeat what I said in a speech this last September at the Annual Meeting of the Board of Governors of the International Monetary Fund. I then indicated that countries had allowed their policies to be determined predominantly by domestic considerations, and that they should, up to a point, try to take an outflow of short-term funds in their stride. But I added that "predominantly" must clearly be taken to mean that other considerations have not to be forgotten. It would indeed be shortsighted to neglect them, even in relation to the main domestic purpose of sustained expansion. If, in an attempt to raise activity by credit and fiscal policies, inflationary pressures are set up, the resulting cost and price increases and weakness in the external balance may soon create conditions under which economic expansion could not be maintained.

If we now try to apply these general principles to the present U.S. situation, I would say, for my part, that the easing of credit conditions recently undertaken by the Federal Reserve System has been the proper policy. There has been a decline of more than $20 billion in the rate of demand for new credit accommodation this year, compared with 1959, mainly as a result of the stronger budget position but also because of the reduction in the growth of inventories. In view of the sharp increase in the surplus of exports over imports of merchandise, it seems to me that balance of payments considerations ought not to stand in the way of the proper measures which should be taken for internal reasons, especially as the transition from an inflationary psychology to the expectation of more stable prices will ensure greater attention to costs. This latter consideration is certainly of crucial importance.

1 See above, page 199.
Control of Costs

The avoidance of cost and price increases is indeed a vital consideration in the formation of U.S. policy, now and in the near future. But before turning to the question of costs, I would like to say a word about interest rates. A policy of pegging either the long-term or the short-term rate of interest by intervention in the market will, of course, not be attempted. This does not mean that credit policy will have no influence on the rate of interest, but it will be more effective if it is allowed to work with the market forces, rather than against them.

Returning to the question of costs and the external balance, I think particular attention must be paid to the fact that on the world markets generally prices have ceased to increase, and that indeed the prices of some raw materials have even declined. Supplies have caught up with demand for fuels (both oil and coal), raw materials generally, and even for most manufactured products. It is my personal belief that the world price level is largely determined by factors outside the United States, even if for some products U.S. demand is of great importance. The imports of raw materials and foodstuffs of Western European countries are nearly three times U.S. imports of the same products. Most of the international commodity markets are situated outside this country and, as I have already mentioned, European competition in manufactured products has become increasingly strong. Before the war, in 1931, when sterling and a number of other currencies were devalued, world prices followed sterling and not the dollar. The United States is self-sufficient in many fields, and often so self-contained that it cannot be expected that the trend of world market prices will really be determined by prices in the United States.

That being the case, it is evident that an increase in costs and prices here will involve the risk of U.S. industries pricing themselves out of world markets. It would obviously be wrong to say that this has already happened, after the very impressive increase in U.S. exports over the last 12 months. Fortunately for the United States—and the world in general—there are many materials and manufactured products, including complicated types of machinery, that the outside world has to purchase in this country, and will continue
to do so in the future. Productivity is high here, but wages are also high. All this means—briefly—that from a balance of payments point of view cost increases should be avoided.

Lessons of History

If we examine past experiences, we generally find that countries which combined cost adjustments with credit expansion fared better than those which did not, certainly as far as recovery in business activity was concerned. Costs can, of course, be reduced in many ways, even without reducing money wages. The more attention that is paid to cost and price adjustments, the less need there will be to rely on massive credit expansion as a means of mitigating a business recession, and only in that way can a more lasting remedy be found. For a policy of cost adjustments through rationalization should make the economy more efficient, and should thus be the policy most likely to improve real wages over a period of time. I have naturally no illusions about the difficulty of pursuing such a policy in actual practice. Such cost adjustments were made, however, in Great Britain and Sweden at the time of devaluation in 1931, and costs were held down in the Netherlands and Switzerland at the time of devaluation in 1936; and I am sure that these countries benefited from the policies they pursued, while those countries in which cost increases continued found it more difficult to reduce unemployment.

I think there can be great merit in studying past experiences in this way and relating them to what one considers is the best theoretical analysis of these matters. Keynes in his General Theory dealt with a closed economy and ignored all balance of payments considerations. This is one reason why I think that it is very opportune to consider his views at the moment, for I have come to the conclusion that the proper policy on costs to be followed here in the United States ought to be very much the same whether internal or external considerations are given the more weight. Indeed, in this country it is almost more important for industrialists to avoid pricing themselves out of the home market, which is so much larger than the markets provided by the export trades. This is emphasized, once again, by the fact that this country experienced no balance of payments difficulties in the 1930's, but at that time accumulated much gold from abroad as a result of Europeans seeking a safe haven for
their funds from dictators and the threat of war. Although the difficulties were thus essentially internal, the measures then taken still failed to cure the evil of unemployment.

Policies to Be Followed Today

Returning, however, to the question of the balance of payments, I would strongly acknowledge that for many countries the adequacy of their gold reserves depends very much on the policies that they pursue. If wrong policies are followed, no amount of reserves would suffice. But given the proper fiscal and credit and cost policies, there are a number of supplementary steps that could be taken in the United States and abroad which would help to improve the position, and I would mention the following:

It is good that individual firms in the United States should be made more aware of the possibilities of the export trade, and should try energetically to develop that part of their business. When home trade is slackening, there is every inducement to do so, and this inducement seems to have been pretty effective in recent months. More can no doubt be done in this field, however.

The U.S. Government and the International Monetary Fund, and, of course, the GATT, have for years pressed for the elimination of trade and payments discrimination against dollar goods. Great progress has been made, but continued efforts are required.

The U.S. Government has also favored a general lowering of tariffs. It is faced with a very tough problem in its relations with the new trading areas, especially in Europe, where it must seek to ensure that U.S. interests are not ignored.

Then there is the whole problem of U.S. Government expenditure abroad, whether for military purposes or for assistance for the less developed countries, as set out so clearly in the President’s statement on steps to be taken with respect to the balance of payments problem, which was made public on November 16. Other countries which have regained their strength during the postwar years may well be expected to assume a larger share of such expenditure. Discussions with some European countries, especially with Germany, are taking place this very month. I am glad to hear that the loans which will be a part of the increased assistance now planned by the Federal Republic of Germany will take the form of untied loans.
Several of the steps I have outlined have already been taken, and others are in the offing. They can certainly make a useful contribution, but as I said before, the fiscal and credit policies pursued, together with continued attention to costs, will be decisive.

Perhaps I should mention certain steps sometimes hinted at, but which in my opinion should not be taken. Although European countries will, as I hope, increase their share of foreign assistance, I do not believe that the U.S. contribution can be substantially curtailed. It seems to me that the many statements made on this subject during the election campaign pointed to continued U.S. concern about further progress in the underdeveloped countries and the importance of continued assistance for that purpose. A greater danger, which should be avoided in any circumstances, would be to increase tariffs. To do so would surely be a double-edged weapon; it would slow up the expansion of world trade, and I need not enlarge upon the dire consequences for the Western world of such a slowing up. Of course, an increase in tariffs and a reduction in the rate of expansion of world trade would reduce foreign competition in U.S. markets, but I am one of those who believe that such competition is salutary—here as in other countries.

It is once again interesting to remember that the increase in U.S. tariffs in the 1930's did not help to combat the depression. Indeed, in those unfortunate years, when other countries, too, raised their tariffs and Great Britain abandoned its free trade policy, we experienced a stagnation of international trade which lasted for a decade and caused great distress all round the world. I hope you will forgive me for referring so often to what happened in the 1930's. While I believe that many useful lessons can be learned from our experience during that period, I would not like to convey the impression that I think we now are faced with the same problem that we faced then—a world-wide deflation. We might all agree, however, that we are in a rather difficult situation and that there is great need for cooperation between the financial authorities in the various countries.

In particular, it is essential that there should be close contact between the financial authorities on the two sides of the Atlantic—what we failed to establish in the period between the two Wars. The International Monetary Fund has been useful in this context, and it is proposed, as you know, to transform the Organization for
European Economic Cooperation, in which the United States and Canada were associate partners, into the Organization for Economic Cooperation and Development, in which the United States and Canada will be full members. I hope very much that this proposal will be speedily adopted, for I think it is in the best interest of all concerned.

Fortunately, today the leading industrial countries have nearly all accumulated sufficient, or almost sufficient, reserves, especially taking into account the secondary reserves available to them through access to the International Monetary Fund. In the next few years I hope we shall be able to consolidate the present exchange structure, and on this basis be able to create the conditions for sustained economic growth. Such growth can occur under a variety of conditions, as past experiences teach us. There was, for instance, a period of rapid economic growth in this country from 1873 to 1895, although at that time prices were, on the average, slowly falling. In the 1920’s there was another period of growth, but then with stable prices, and after World War II there has been growth with rising prices. In each of these periods, business attitudes and practices have had to be adjusted to the prevailing trend. Assuming that we may prevent both inflation and deflation, we shall have to adjust our practices to the requirements of a more stable price level, which I am fairly confident that we shall be able to ensure. For my own part, I have no fear that a period of stagnation will result. In fact, I listened with great pleasure to what the Chairman said here today about the goals of monetary policy of the CED. It is my opinion, too, that the attainment of a satisfactory rate of growth and higher employment and the preservation of a relatively stable price level are fully consistent goals. In view of the great technological developments, and for other reasons, demand for capital all over the world may be expected to be large, and there should be no accumulation of idle savings.

There is work of noble note to be done, and with the greater insight and the more effective institutions that we now possess, there is every reason to believe that we shall be able to do it.
The Fund in 1960/61 *

The over-all economic developments in the year that has passed since I last spoke to the Economic and Social Council here in New York must be regarded in many respects as favorable, even though there have been continued difficulties and problems for some countries and areas. For the world as a whole, industrial production was 6 per cent higher in 1960 than in the previous year; as there was also a generally increased output of agricultural products and raw materials, and an expansion almost everywhere in the service trades, the world economy had another year of substantial growth. It was in the industrial countries of Western Europe and in Japan that the increase in production was most marked; and an average rise of nearly 20 per cent in the imports of these countries contributed toward an increase in world trade of no less than 10 per cent, despite some reduction in the imports of the United States. For the primary producing countries, the rise in world demand meant an increase in their exports by some 6 per cent. This proved for many of those countries to be of help to their general business position, and produced higher receipts in their balance of payments, even though the general level of raw material prices tended to decline slightly during the year. The introduction of external convertibility by a number of European countries at the end of 1958, and the increase in their production, intensified competition on world markets for manufactured articles of all kinds—tools and machinery as well as consumer goods—and this led to greater price stability. The important characteristic of the last year and a half has indeed been that pronounced boom conditions in a great many countries have not been combined with any increase in the general price level on world markets for either primary products or manufactured goods.

This had a marked effect on conditions in the United States and also in Canada, two countries which have been passing through a

* Address before the UN Economic and Social Council, New York, April 20, 1961.
1 See above, page 146.
period of adjustment clearly connected with the halt in inflationary price increases and the expectation of more stable prices. In Canada, a special problem was the continuing reduction in the volume of business investment from the peak in 1957. As far as the United States was concerned, the recent adjustment has led to a distinct slackening of activity rather than a sharp setback in business. Final demand (as measured by the aggregate of consumer buying, business investment in plant and equipment, expenditure for housing, net exports, and government purchases) increased all through the year, and the volume of fixed investment was in fact well maintained. But an accumulation of inventories at an annual rate of over $11 billion in the first quarter of 1960 changed into an inventory liquidation at a rate of $3 billion in the last quarter of the year. Under the impact of this change, industrial production declined by 7 per cent; and unemployment increased to the highest percentage since the end of the war. Merchandise imports fell slightly, but exports rose from $16.2 billion in 1959 to $19.4 billion in 1960, and there was thus an export surplus of $4.7 billion.

I mention this latter development in particular because it indicates the improvement in the basic position of the balance of payments of the United States. The external convertibility of so many currencies now makes it possible to transfer short-term funds more freely, and, as you know, there have been substantial movements of such short-term funds over the last year. These movements have attracted great attention, and have tended to overshadow the changes that occurred in the basic conditions of the balance of payments of several countries. In particular, in the United States, the net income in 1960 from investments and services (amounting to over $2 billion), added to the trade surplus for that year, yielded a total of some $7 billion, which was more than sufficient to cover all government expenditure abroad, including expenditure for military purposes and official foreign assistance of all kinds. However, the movements on capital account—movements of short-term funds and private long-term capital investments abroad—resulted in an over-all deficit of $3.8 billion. At the same time, it should be remembered that when domestic capital flows out foreign assets are acquired, and there is also the possibility of a return flow. It is too early to tell whether any substantial amount of short-term funds has yet returned to the United States, but for
the last three months the strain on the dollar has been much diminished. This has, I think, helped people to form a more realistic opinion about the intrinsic strength of the dollar, particularly when they bear in mind that, even after the recent reductions, the gold stock of the United States still amounts to $17.5 billion and is nearly as large as the combined gold holdings of all the other member countries of the Fund. Even given the magnitude of existing short-term dollar liabilities, this is a very strong position.

Return to Convertibility

Turning now to the industrial countries other than the United States, the remarkable expansion in their volume of production over the last decade has by and large been accompanied by an impressive improvement in their liquidity position, helped as it has been by the outflow of gold and dollars from the United States over recent years. The reserves of these other industrial countries are now some two and one-half times as large as they were in 1950. They total some $27 billion, and should—in most cases—be quite adequate for these countries. A number of them have felt that their reserves and their general balance of payments position were sufficiently strong to make possible the formal acceptance of the obligations of convertibility for their currencies envisaged in the Articles of Agreement of the Fund. In February of this year, therefore, nine countries in Europe, together with Peru, and followed more recently by Saudi Arabia, decided—after consultation with the Fund—to forego the special privileges of Article XIV of the Fund Agreement, under which member countries are permitted to maintain and adapt exchange restrictions without obtaining the prior approval of the Fund. By accepting the convertibility obligations of Article VIII, they are required to avoid restrictions on current payments, multiple exchange rates, and discriminatory currency practices, and if they ever again wish to resort to such measures, they have to consult the Fund and obtain its prior approval. In all, 21 member countries are now subject to the provisions of Article VIII. One result has been an increase in the number of currencies which may be used in repayments to the Fund, and sterling was used for that purpose for the first time, in February, by Burma.
The Fund has played a part in this return to convertibility by providing financial assistance to a number of the countries when they were in difficulties in earlier years, by pressing for progress in the removal of restrictions in general statements of policy, and by advising how this could be done in the regular consultations held annually with all Article XIV countries. Important as these moves to convertibility are, they are not likely to reduce the work of the Fund, and, in fact, the Fund's consultation work is expected to increase. For, in a decision on June 1, 1960, the Executive Board of the Fund expressed the view that there is great merit in periodic discussions between the Fund and its members, including those that have convertible currencies, even though no measures requiring approval under Article VIII are maintained. Such discussions will be planned between the Fund and the member, including agreement on place and timing, and will ordinarily take place at intervals of about one year. The Executive Board favored such discussions because they felt that the Fund is able to provide technical facilities and advice, and that it would be desirable to exchange views on monetary and financial developments in the member countries.

Among the nonindustrial countries of the world, there have been, I am glad to say, a few which have been able to increase their international reserves in 1960. Over the last decade, however, the international reserves of the less developed countries that are members of the Fund have remained remarkably stable at around $10-13 billion. In many cases the reserves are clearly not adequate, particularly in the light of the expansion in the foreign trade of these countries. Even if their primary objective is to direct resources toward investment for the further development of their economies, many of them would probably be wise if they could strengthen their reserves, for by doing that they would increase their creditworthiness, and thereby attract more resources from abroad on a continuous basis. At the same time they would then have a more adequate cushion against fluctuations in the prices of their main export products.

Considering the difficult reserve position of a number of the less developed countries, it is natural that over the last few years they,

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2 See above, page 192.
in particular, have requested assistance from the Fund. During 1960, none of the drawings, which totaled $280 million, was made by any of the highly industrialized countries. On the contrary, several of these countries made advance repayments to the Fund—for instance, the drawings made by France and the United Kingdom in the years 1956-58 were fully repaid to the Fund in the course of last year. In all, repayments amounted to $650 million in 1960, and thus exceeded drawings by almost $400 million. The improvement in the liquidity position of the industrialized countries has thus been reflected in the financial operations of the Fund, leading in fact to a strengthening of the Fund's own liquidity position.

**Economic Cooperation**

There are today two seemingly opposite tendencies in the world: on the one hand, political fragmentation by the emergence of many new states; and, on the other hand, economic integration by the formation of trading areas—in Europe, the European Economic Community and the European Free Trade Association; and in Latin America, the Latin American Free Trade Zone and the Central American Common Market. Undoubtedly, countries wish to regulate their own affairs with all the rights and powers inherent in independence, but, at the same time, they are fully aware of the fact that in this complex and shrinking world they must cooperate with each other in many fields, including the monetary and financial fields. Let me then state most emphatically that the acceptance of currency convertibility has not in any way diminished the need for monetary cooperation. One may even say that it has had precisely the opposite effect. As a result of currency convertibility, national economies are much more closely interrelated, and changes in prices, monetary conditions, and other economic developments in any one country react more quickly on others. It is clear that no single country can determine the price levels on world markets. The efforts of the monetary authorities to prevent any marked tendencies toward either inflation or deflation will thus be heavily influenced by developments abroad. The monetary authorities in the various countries must therefore, if and when the need arises, be prepared to agree upon the main lines of policy required to achieve a reasonable stability of prices. Apart from such major matters, there will always be need for contact and understanding in the more everyday work.
As a result of the greater convertibility of currencies and the widespread relaxation of exchange controls, the opportunities for movements of funds from one country to another have substantially increased—for instance, to take advantage of interest rate differentials. There is clear evidence that there have been appreciable movements of commercial bank balances and of funds held by large international companies. The most recent example of such international movements of funds came in the wake of the revaluations of the deutsche mark and the Dutch guilder, on March 6 and 7 this year. These revaluations were intended to help to establish equilibrium in the world payments position, and thus to eliminate the uncertainty that had been prevailing for some time in certain quarters about the future value of the deutsche mark. It was therefore made clear that these two moves should be regarded as definitive. Despite declarations by the governments of other countries that they had no intention of altering the exchange value of their currencies, rumors continued in the markets and led to the substantial movements of funds to which I have referred. Countermeasures have now been taken, largely as a result of effective central bank cooperation. There is no doubt that it is the determined policy of the countries concerned to fortify the exchange structure at present rates, and that the resources available to them are more than sufficient to achieve that purpose.

International Reserves

At the end of 1960, central banks and governments, other than those of the Soviet bloc, held reserves amounting to nearly $60 billion, of which $38 billion was in gold, $10\frac{1}{2} billion in dollars, the equivalent of $7 billion in sterling, and some $4 billion in various other currencies. In addition to the consideration that interest can be earned on holdings of foreign exchange, the countries that hold part of their reserves in that form find it useful and convenient to do so, partly because the two main reserve currencies are also the two main trading currencies of the world. The system under which most countries hold their reserves partly in gold and partly in reserve currencies is the present-day version of the “gold exchange standard.” This was the system which, as you know, was built up in the decade after World War I; but the difficulties then confronting the world, and the lack of international cooperation,
led to the breakdown of the system. While it may be an open question whether any monetary system could have passed unscathed through the events of those years, there are, I think, two specific reasons why the system broke down. In the first place, the exchange reserves of many of the European countries had been acquired by large-scale short-term borrowing in the 1920's. Once the crisis set in, these short-term loans were not renewed and the reserves melted away. Today, on the other hand, countries have by and large earned their exchange reserves from current international transactions. The second weakness of the system of the 1920's was the absence of any international agency standing behind the national reserves. The Fund now holds that position, and the enlargement of the Fund's resources of currencies and gold by the equivalent of $5 billion, as a result of the increases in quotas in 1959 and 1960, is therefore of particular importance. Thanks to the added resources available in the Fund, which now total the equivalent of almost $15 billion, the present gold exchange standard has a strength that was lacking in its predecessor of 30 years ago.

All members, large and small, have access to the Fund's resources under adequate safeguards, and I would like to point out, as I did in my statement at the Annual Meeting of the Board of Governors last September, that assistance by the Fund is given for a variety of reasons, and should not be regarded as available merely in emergencies. The authorities in a number of countries, such as Australia, the United Kingdom, and the United States, have also made it clear that they share this understanding, that they count on their country's drawing rights in the Fund as part of their effective reserves, and that they would not hesitate if necessary to make use of these rights.

The international monetary system can never be a rigid system, with fixed and permanent arrangements. It must be such that it can develop with the varying growth of the individual national economies, and with the evolution of their financial and monetary needs and potentialities. Accordingly, the tasks and methods of operation of the International Monetary Fund should not be fixed, but must be responsive to the changing needs and conditions of its members. When the Fund began its operations in 1946, most

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3 See above, page 198.
currencies were still subject to the strict exchange controls set up during the war, and trade was still largely carried on through a network of bilateral trade and payments arrangements. Today, trade and payments restrictions and discriminations have generally been removed and nearly all international trade takes place on a multilateral basis, with the more important currencies convertible under the Fund Agreement. As the situation has developed, the Fund has been reviewing its activities and adjusting its practices so that it will be able to meet more adequately the needs of its members in this new world of freer trade and convertible currencies.

Over the last few years, for instance, there has been a change in the currencies which have been drawn from the Fund. For the first 10 to 12 years of its life, the Fund was primarily an agency from which member countries drew U.S. dollars and made repayments in dollars or gold. Now that so many countries have re-established their monetary position, it is proper that drawings should be made in a wider variety of currencies. Indeed, in order to integrate Fund operations into the multilateral system of world payments, it is most appropriate for drawings to be made, in general, in the currencies of countries with a strong payments and reserve position. Much progress along these lines has already been made. While in 1957 all drawings were made in U.S. dollars, in 1960 almost one half of all drawings were in other currencies, and this proportion has been even higher in recent months.

The greater freedom for movements of funds has focused new attention on the extent to which the Fund can finance adverse balances of payments on other than current account. Article VI, Section 1, which is entitled “Use of the Fund’s resources for capital transfers,” declares that net use shall not be made of the Fund’s resources to meet outflows of capital which are described as large or sustained. But the section specifically does not prevent use of the Fund’s resources for capital transactions of reasonable amount required for the expansion of exports or in the ordinary course of trade, banking, or other business. The Fund is now engaged in examining the legal and policy aspects of these provisions.

**Adequacy of the Fund’s Resources**

One of the main objectives of the Fund is to promote exchange stability, and to do that the Fund must have considerable resources
at its disposal to be able to act decisively in all foreseeable circumstances. Its resources are already large—as I have mentioned, they amount to almost $15 billion, of which some $2\frac{1}{2}$ billion is in gold and some $7$ billion in convertible currencies. These resources should be quite sufficient for most situations that the Fund might have to meet. But there is always the possibility that circumstances might arise in which the Fund might need additional supplies of certain currencies. Such circumstances were foreseen in Article VII of the Fund Agreement. If the Fund's holdings of a particular currency are deemed inadequate, the Fund is empowered to replenish its holdings by borrowing such currency or by buying such currency for gold. The latter method was used in 1957, when the Fund sold $600 million of gold to the United States to obtain dollars needed to meet the large demands for dollars anticipated at the time. However, I believe that the Fund should be sparing in the use of its gold for this purpose, particularly because we should regard our gold holdings as a reserve to be used only in situations in which no suitable alternative is available. It therefore seems that the time is now ripe to consider the first method of acquiring particular currencies, namely, borrowing. Needless to say, the development of this new technique to supplement the Fund's resources of particular currencies will require careful consideration, and work has begun in the Fund on the examination of the many aspects of this question. We may have to use a variety of different methods. The most appropriate method seems to be the conclusion of a network of stand-by arrangements with the main industrial countries, under which the Fund will be able to use increased amounts of their currencies whenever the need for such use would arise as part of a Fund operation. Our aim is to look beyond immediate needs and to seek to equip the Fund to be able to handle flexibly the many and varied situations that may arise under a system of freely convertible currencies. In this way we can help to ensure the viability of the present payments system.

I have referred to the development of Fund activities in order to show that action has already been taken and experience is being gained, even though a great deal of exploration and discussion is still before us in certain fields. A great interest is being taken in many circles in all these problems, which I highly welcome since it is evidence of the great importance that people place in the
strengthening of the international monetary system. The Fund in its work is trying to proceed along lines which are essentially practical and which are likely to be generally acceptable to the member countries. In my opinion, the Articles of Agreement give sufficient latitude for constructive arrangements to be made which will meet the needs of members under present and foreseeable conditions. Consideration of these problems has come at an opportune moment when they can be examined deliberately and carefully; for while a number of countries still have to overcome internal and external difficulties, their situations have not been aggravated during this last year or two by any decline in the volume of world trade or any general lack of liquidity. Neither can one say that the purely political events of the last few years have much affected the flow of trade, or in any large degree the movements of funds. We do not know for certain that these relatively favorable conditions will continue. This being the case, individual countries and international organizations should take appropriate action while circumstances permit them to do so.

Problems of Less Developed Countries

While some of the problems with which the Fund has to deal and to which I have referred today—for instance, the replenishment of the Fund’s resources by borrowing—will principally concern the leading industrial countries, it is well to remember that, especially in recent years, the extension of financial assistance by the Fund has been almost exclusively to the nonindustrialized member countries. It is perhaps useful to point out that when the Fund’s resources were enlarged in 1959, the quotas of the less industrialized countries as a group—and hence their potential drawing rights—were increased proportionately more than those of the industrial countries. The Latin American countries, for instance, which in 1946 had quotas that totaled about 6 per cent of all Fund quotas, had, after the enlargement of the Fund’s resources in 1959, quotas which came to 9 per cent of the new total. And at the present time these countries have together used a larger proportion of their quotas than has any other group of countries. There is no doubt that the raw material producing countries have special difficulties, for, although their exports increased in 1960, average prices tended to decline slightly, as I have already pointed out. Experience seems to show that either Europe alone, as was the case in 1960, or North America alone, can lift the volume of world trade; but
that it takes booming conditions on both sides of the Atlantic to have much effect on the general level of the prices of raw materials.

The question of fluctuations in the prices of primary products on world markets has been a subject for much discussion. We have recently received the report of the group of experts appointed by the Secretary-General of the United Nations on "International Compensation for Fluctuations in Commodity Trade." This report devotes a great deal of careful attention to the operations of the Fund, and the manner in which the Fund's resources can be marshaled to help in the solution of this problem. We have not yet had an opportunity to study this report in detail, but I would like to express at this early stage our continued deep interest in the matter.

There is a growing awareness in the world of the need to assist the less developed countries in their efforts to achieve better economic and social conditions. It is a question not only of economic development by a diversification of their production on the basis of their own and foreign resources, but also of progress in many other fields, such as health, education, housing, taxation reform, and so on. The countries themselves have, of course, responsibility for the changes to be made, but international agencies, each one in its own field, also have a role to play in providing much needed assistance, technical and financial.

The Fund's particular concern in the less developed, as in other, countries is to assist them to have a healthy balance of external payments and to maintain monetary stability at home. But the value to a country of the Fund's work is not limited to what the Fund does in its direct relations with that country. It is well to remember that the earning possibilities of the primary producing countries depend, as we have seen, very much on the general state of world trade, as influenced largely by business conditions in the leading industrial countries. Therefore, the Fund's efforts to promote international monetary cooperation, to facilitate the expansion and balanced growth of world trade, to promote exchange stability, and to pursue its other purposes, are in the interest of all its members. Despite the many problems that remain to be solved, great improvements have been made in the world's economic and financial structure, and, with the help and understanding of member countries, there should be real opportunities for consolidation and further advance.
Current Economic Problems *

I speak today on current economic problems. I must say that I do it with some hesitation as I have not been in Europe for ten months and naturally I have, therefore, come here mainly to listen and not to talk myself. I have, of course, had the advantage of meeting many personalities, many of them old friends, at the Annual Meeting of the Bank for International Settlements, which is one of the best occasions I know for learning about Europe and the world at large. And there I have heard this afternoon the President, Dr. Holtrop, give what I would call a relatively optimistic picture of the conditions in the industrial countries of the world. He pointed out, however, the existence of some dangerous disequilibria and some pronounced business trends that give some occasion for reflection. I have not yet had the time to read the BIS Report, apart from the introduction and the conclusion, but I know how much I shall learn from it.

The most striking thing about the world economy in 1960 was surely the diversity of trends and conditions. The pronounced boom in Western Europe and Japan, the slackening of activity in the United States, the generally rather difficult conditions of the nonindustrialized countries related to a slight decline in the average level of raw material prices.

U.S. Economic Situation

Let me begin to talk about the United States. The upward trend in activity went on quite nicely in 1959, but was, however, upset toward the end of the year by the steel strike. And those who remember the general optimism of the latter half of 1959 know how great were the hopes about the decade called the "roaring sixties" that was to come. But things turned out differently. There was soon a slackening in business activity in the United States with a decline in output, not very large but noticeable, and a marked

* Speech at the Basle Centre for Economic and Financial Research, June 12, 1961.
increase in unemployment—but still quite a high level of private investment in plant and equipment. In some ways this was a strange kind of business setback. There has been an interesting discussion in the United States whether or not this setback should be called a "recession." It depends, of course, on what should be meant by a recession . . .

Those who regard the shift in inventories, and many do, as the typical feature of booms and recessions, will naturally call the slackening in activity that took place in 1960 a recession. They are fully entitled to do so. But I learned as a young man from Gustav Cassel and others that the typical characteristics of booms and recessions—or depressions as we used to call them before we became so considerate—were the cyclical changes in investment in plant and equipment. The recession was, for them, the after-effect of the pronounced increase in investment in plant and equipment, leading, as a reaction, to a decline in such investment. No such movements of any significance occurred this time and, whatever we call the recent slackening in activity, we have surely reasons to inquire why we had such a peculiar kind of setback.

For my own part, I have little hesitation in thinking that this recent slackening was due to the sudden realization of the fact that prices would not continue to rise, that there would not be even a "creeping inflation." American businessmen had suddenly to learn how to live without inflation. That is not an altogether easy thing to learn. We have seen in country after country that when an inflationary mentality is changed into the expectation of more stable prices, a period of adjustment is needed. I could mention half a dozen or a dozen countries where that has happened. The United States' economy has just passed through such a period. From what I hear from some leading industrialists, the prices they charge for many lines—electrical equipment and others—are now some 5-6 per cent lower than they were in 1959. Great efforts have often been made to reduce costs. I heard that one large public utility company carried out all its planned investment and that the cost was about 5 per cent less than estimated—as the investment ran into $50 million, the saving was considerable. There can be little doubt about the general trend and that in a large part of manufacturing industry there is a tendency toward a decline in prices . . .
Prices and Wages

Under the impact of, let us say, "non-rising" world market prices, I do not believe that prices in the United States will rise significantly—and some prices may even decline. If that is true it would exclude the possibility of even a creeping inflation. I must tell you, however, that there are some very able men who do not agree with me on this point. On Sunday, March 5, this year, Professor Paul A. Samuelson from the Massachusetts Institute of Technology—a very able and respected economist—gave his opinion in a "Meet the Press" television interview that he would be content if the official price index could be held down to an increase of no more than 1½-2 per cent a year. I should add that he thinks this will be largely offset by an improvement in quality.

Personally, as I have said, I doubt whether the price rise in the United States can be as large as that, for I think it will be very much determined by the competition that comes from abroad, from the lower wage countries, from the European countries. Of course, it is nothing new in world history that world prices should follow European prices more than prices in the United States. That was the case in 1931, when, as you know, world prices followed sterling and not the prices on the United States market. And I think that we have a return of those circumstances today. It is still remarkable, however, that American economists often speak as if the United States would be free to determine by its own policies the trend of prices. Professor Slichter thought to the end of his days that that would be so. I believe that to be a misconception—a misunderstanding of the realities of the situation.

In his "Meet the Press" Conference, Professor Samuelson tells quite frankly why he would be content, as he says, with such a price rise—of 1½-2 per cent a year. He is afraid that the alternative might be stagnation, because in a strong private investment boom, when there is no slack in the labor market, under the collective bargaining setup there would be a tendency for each wage bargain to be settled on the high side.

So in this way we are back to the question of costs. This question is at present discussed as intensely in the United States as elsewhere. For the moment it has to do with the recovery from the slackening in activity that has taken place and with the absorption of the
unemployed. As you know, two developments are taking place in the United States at present, which can only be regarded as satisfactory.

One is the disappearance of the deficit in the balance of payments—to which I shall refer in a moment; the other is the recovery in business.

It seems that the transition period during which business adjusts itself to the new price trend—slightly declining instead of rising prices—is largely over and, with a greater ease in credit policy, production is rising and rising quite well. But will this recovery reduce the high rate of unemployment?

There will, no doubt, be some improvement. But what is beginning to be realized is that much will depend on the wage trend. If wages rise, even with more financial ease, there will be less reduction in unemployment. This, may I add, is in conformity with any respectable economic theory—but most notably in accordance with Keynes’ views as expressed in his *General Theory*. It is often forgotten that Keynes defined liquidity in terms of labor or wage units—and that he made it clear that if wages rise in a depression, unemployment is not likely to be much reduced even with an increase in liquidity. This is fully recognized, I think, by the best commentators on Keynes and notably by Professor Alvin H. Hansen in his book, *A Guide to Keynes*. And on March 12, this year, there appeared in the *The New York Times Magazine* an interesting article by Professor Hansen entitled “An Appeal for a Dual Economy,” in which he, on the one hand, urged an expansion in demand as well as other things, but on the other hand gave the following warning:

A danger signal needs to be hoisted. The increased aggregate demand springing from these programs could evaporate in higher prices and higher money wages with no gains in output and employment. There is, indeed, great danger that this may happen in whole or in part. This is a hard fact of contemporary political life, not only in our own country but throughout the free world. We cannot permit administered pricing and collective-bargaining wage contracts to rob the country of the employment and output increases which expansional measures are designed to achieve. To this end, President Kennedy has appointed an Advisory Committee on Labor and Management Policy to encourage productivity gains, sound wage policies and price stability.

I think Professor Hansen quite rightly referred to President Kennedy’s “Advisory Committee on Labor and Management
This is—as the name indicates—an Advisory Committee, but it is part of President Kennedy's attempt to give more direction to American life, which, I think, is approved generally by the American public. It is obvious that the Government cannot seek to fix wages, but it can provide the conditions for a greater understanding of what the situation demands.

I think that market conditions in the United States now favor a moderation in the increase in wages. It is not only the existence of fairly widespread unemployment—though that is playing a role—but also the shrinking of profit margins which naturally leads to greater resistance by employers. It seems to me that American labor is beginning to pay greater attention to job security than to an increase in wages. Questions arise about the retraining of workers and other measures to promote the mobility of labor, both important aspects of automation and other technical developments at a time of strong labor organizations. Labor unions will, however, continue to demand an increase in wages—it is their business to do so. Very much depends, then, upon the general climate of opinion and the resistance exerted by the employers to such increases. That resistance, as we have seen in many countries, will be influenced by government attitudes even if there is no coherent official wage policy adopted in the country. And therefore the discussion of these problems and the attempt to bring about a favorable climate of opinion and understanding is, I think, of the utmost importance.

Therefore, I think that in this situation the Advisory Committee on Labor and Management Policy can exert a very useful influence. Conditions vary from country to country, so that the direct imitation of institutions is rarely possible, but here is surely an innovation that ought to be carefully considered by other countries; many of them might be wise if they, too, were to establish some body concerned with the problems of the efficiency of industry as affected by labor management policies.

**U.S. Balance of Payments**

In the United States we have seen in recent weeks and months the signs of a recovery of business and also an improvement in the balance of payments. Already in the course of 1960, the exports of the United States increased considerably, while imports
declined, so that there was a basic improvement in the balance of payments. For the present year the surplus on trade account is running at an annual rate a little above that of the last quarter of 1960, with exports at an annual rate of about $20 billion and imports of about $13\ 1/2\ billion, giving a difference of $6\ 1/2\ billion as the trade surplus. With the net income from investments and services, the current account balance is thus running at a rate of over $9\ billion a year—not a bad sum! It is fully covering all military expenditure abroad, all government aid, and also long-term investments. And if, with an improvement in business in the United States, interest rates would stiffen somewhat and there would be no outflow of short-term funds, it is likely that there would be probably no over-all deficit in the United States balance of payments and possibly even a slight surplus.

No doubt, United States exports have been helped by the boom in Europe and the slackening in the domestic economy, which gave and still gives U.S. industry a great advantage in delivery dates. There are those who think that the recovery in the United States economy will perhaps somewhat reverse these conditions, but I do not personally expect any sudden reversal ...

Especially for some countries in Latin America and elsewhere, the decline in United States imports has been a matter of embarrassment, and it is not surprising that these countries have turned to the International Monetary Fund for assistance. . . . the twenty-one countries which have turned to the Fund for financial assistance during the past year, that is to April 30, 1961, . . . are almost all industrially less developed. I do not say that in all or even most of them their difficulties have arisen only from the trading conditions of the last year. In several, they are of longer standing and have other causes. These arrangements with the International Monetary Fund have involved programs for the restoration or maintenance of monetary stability, and we in the Fund have been impressed by the efforts made by so many countries in difficult positions to master their problems. They show great determination to withstand and overcome inflationary pressures.

European Growth

Turning now to Western Europe, one finds good business conditions, great vigor and a spirit of enterprise that is very gratifying. The economic upsurge of the European countries has been a
blessing to themselves and to the rest of the world, not only to the underdeveloped countries but also to the United States, because of the boost that it has given to higher imports.

But even good economic conditions create problems. It has not been easy to determine what should be the proper monetary policies. On the one hand, the authorities had to take steps to contain the boom; on the other hand, they had to avoid disturbing the international equilibrium. Normally in a boom they would have to raise interest rates to withstand an excessive upsurge, but if they did that, they might attract more funds from abroad, which might still further inflame the boom. Partly this difficulty has been due to the difference between the economic trends on the two sides of the Atlantic. This has happened before, but never, I think, in such a pronounced way. I have followed international economic developments for over 40 years and I have never ceased to be astounded about the new situations that occur, but this is indeed a situation for which no solution is to be found in the textbooks, and for which there are no clear precedents. I think the central banks have shown great flexibility in their thinking and have been ready to weigh different considerations against each other.

I was in Great Britain last week. There, too, I found a rate of investment in plant and equipment, especially in manufacturing industry, that was greater, I think, than in any postwar year. This is a very encouraging sign because I had in the past been a little afraid that the heavy burden remaining from the war would affect the vigor of that country. Now the task is, of course, to find room for a continuation of this investment and also for increased exports to help the balance of payments. And that brings one back to consumption and budget policy. In the last British budget there were increased taxes—some were lowered and others increased—so that there is a surplus of £506 million above the line, and the over-all deficit is only £69 million after taking account of all investment expenditure of the Government. This is more than covered by the cash income from social insurance funds and from small savings. Certain economic stabilizers have been included in the budget which, once they have been approved by Parliament in July, could be applied to decrease consumption. So budgetary steps have already been taken, and others may be imposed in the course of the summer. One interesting aspect of this, as Dr. Holtrop said
in his speech today, is that there is a tendency to rely a little more on budgetary measures and not solely on monetary policy to achieve and maintain economic balance.

We have now a world of at least externally convertible currencies, with much reduced trade discrimination and hardly any payments discrimination. This has been a good thing. Without convertibility, I do not think we would have had the upsurge in world trade that has taken place. But convertibility creates certain problems, too—it is now easier to move funds from one market to another. And funds are moved to profit from interest rate differentials and for other reasons. Such movements have to be regarded as an almost normal element in the convertible system—and should normally bring little difficulty. But these movements can be intensified by extraordinary occurrences and sometimes mistaken notions. Last autumn and winter there was a movement of funds out of the United States, partly because of devaluation fears, especially after the price of gold on the London market had risen to nearly $40 and for a few hours had even exceeded $40. I said at the time that I did not think monetary policy would be determined by the misconception of speculators. Soon it became clear that there is strength in the dollar.

**Currency Stability**

Another occurrence has been the revaluation of the deutsche mark and the Dutch guilder. I will not go into the question of the merits of this move—that is past history. But I must refer to some of its consequences—movements of funds induced by what I again think are mistaken notions about what will happen. In my position in the Fund, I hear of course what people say and can observe the consequences of their actions, and then I also tell them as best as I can what I think is happening. In this connection I would like, here and now, to make the following considered remarks:

In the past three months the economic world has been plagued by rumors of further currency changes. These rumors seem to me entirely baseless. They are, however, very damaging to confidence and people would do well to consider how much harm they do in inventing and spreading such rumors.
I happen to know that in all the major financial centers the monetary authorities are determined to maintain existing parities. There is no foundation whatever for the rumors that there are some new plans under international discussion for currency adjustment, whether by revaluation, devaluation, widening of margins, or in any other way.

I have been very glad to see in Basle, this weekend, renewed confidence in the firm attitude of the central banks and in the effective cooperation which is going on between them. Both this attitude and this cooperation have the warm support of the International Monetary Fund.

Traveling as I do from country to country, I see very little difference in price levels—I believe we are approaching a situation of much greater balance in this respect. We have convertible currencies, we have a system which it is in our common interest to strengthen and solidify, and I think we shall succeed in doing so. The economies of the Western world show on the whole great vigor and impressive rates of investment. And I think we have greater possibilities than in the past to overcome the difficulties we have to face.

We must not forget that the currency changes in the 1930's were caused not by inflation but by deflation—by a fall in prices—which began outside Europe and was conspicuous in the United States before it made itself felt in Europe. I am sure that there will be no such deflation now; the economic system could not endure it and, of course, nobody wants it. U.S. policy is certainly not framed in that direction.

Another difference is that now we have in the International Monetary Fund an institution endowed with considerable resources which can render its assistance in appropriate circumstances—and, as you know, on the basis of programs which are designed to remedy unbalanced situations. We also have closer central bank cooperation. I think that there were two distinct—though perhaps unintentional—consequences of the revaluation of the deutsche mark and the Dutch guilder:

(1) In wide circles people have become so distressed, not to say, disgusted, about the consequences of currency changes that in fact the determination to defend the present parities has been strengthened.
The central banks—including the Federal Reserve System of the United States—have decided to cooperate more closely through the granting of credits and in the forward exchange markets.

Further steps can and should, I think in the opinion of most people, be taken to strengthen our present system. The ideas naturally concern the International Monetary Fund. Even if the Fund is now very liquid, we have to consider what might happen in the future. The Fund should be in such a position that it could meet the needs of all its members—big and small—including the United States. If it were not able to do so, there would be a serious deficiency in the whole structure. It is possible to strengthen the Fund on the basis of its present Articles of Agreement through the use of its powers to borrow. It may be that such additional resources will never need to be much used. But remember the stabilization credits arranged between central banks on so many occasions in the past. They were generally not used, but nevertheless they were very useful. I think one ought to do one's best to get rid of the bugbear of a lack of international liquidity in the official field. In the private field we have plenty of liquid resources, but just because of the great liquidity of private institutions—industry and banks—we need to have greater resources in the hands of the official institutions to meet the possible onslaught of international movements of private funds. If we can succeed in removing the bugbear of a lack of international liquidity, then the responsibility for any imbalances would more definitely be thrown back onto the individual country. This is a policy designed to establish not less but enhanced financial responsibility in the world.

As I said before, the industrial countries in Western Europe, and Japan, show very great vigor and have very little unemployment. In these countries—and in the United States and Canada as well—there is a high rate of investment. Great progress is also being made in many nonindustrial countries. We have to seek to establish such conditions that these, in many respects so favorable, developments can continue—and we have to provide against the strains and stresses of a possible setback.

Over 40 years I have seen many shifts in fortune—and I would like to think that we are making the proper preparations to be able to face whatever difficulties—and they may be many—which we
shall have to meet in the future. Pasteur said, "Fortune favours the prepared mind." I think fortune also favors the prepared institution. There are many ways in which our system can be strengthened by action in the individual countries and by international measures along practical lines. I should think that it is in the interest of all of us to use the present opportunity to prepare adequately for the future.
May I begin by saying how much pleasure it gives me that this year’s Annual Meeting is being held in Vienna. For me, personally, our presence here brings back memories of quite a long time ago—of the time of the League of Nations Reconstruction Scheme for Austria after World War I. In the summer of 1925 I served as one of the secretaries to Mr. Walter Layton (now Lord Layton) and the late Professor Charles Rist, who had been asked by the League Council to report on the economic position of Austria. These two experts came to the conclusion that Austria was economically viable; but when they made their report at the League of Nations Headquarters in Geneva there were those who thought that they had been too optimistic and dubbed them, after a vaudeville show then running in London, “the co-optimists.” This time, however, the optimists proved right. Whatever the vicissitudes through which this country has had to pass, it has undoubtedly established itself as a proud and independent nation, thanks to the fortitude, resilience, and vitality of its people: qualities as deeply rooted in them as those of charm and good humor, which are perhaps more readily apparent.

It might be of some interest to examine the developments of this last year against the background of the situation at the end of 1959 and early in 1960. Many countries were, of course, faced with difficulties, but world economic activity was generally at a high level and showed signs of increasing. The adoption of external convertibility by a number of European countries at the end of 1958 had clearly been successful, and there had been an almost all-round increase in their gold and foreign exchange reserves. The rise in the general price level had been much less accentuated during 1958 and 1959, holding out the hope that the postwar inflation had at last been contained.

* Statement presenting the Annual Report of the Executive Directors of the Fund to the Board of Governors, Vienna, September 18, 1961.
New Problems

The growing freedom for the international movement of funds, as a result of the increased convertibility of currencies, and the greater stability of prices—so welcome in themselves—have, however, created new problems which the world has not had to face since the start of World War II. Some of these problems were discussed at our last Annual Meeting, others have developed since that time. I believe that much of the disquietude that arose in this new situation was not really justified, but while it lasted it certainly exerted a disturbing influence. In the United States, mainly under the impact of a change in inventories once prices had become more stable, industrial production declined after the spring of 1960 and unemployment increased to the highest percentage since the end of the war. In the spring of this year, however, business activity began to recover, so that the setback proved to have been of short duration. Even so, it was not without influence on the international monetary situation. As was natural in a period of recession, interest rates in the United States declined; and with boom conditions and fairly high interest rates ruling in most European countries, it was to be expected that there would be an outflow of funds from the United States. This outward movement coincided with growing misgivings about the competitive power of the U.S. economy, and also with some apprehensions connected with the election. A temporary flight from currencies into gold led to a steep rise in the price of gold in London, which in turn intensified these fears and gave an impetus to fresh rumors and speculations. All this occurred at a time when there was a remarkable and continuing improvement in the basic position of the U.S. balance of payments. Imports were tending to fall as a result of the decline in business activity, but exports had risen substantially, and there was a trade surplus of more than $4.5 billion for the whole of 1960. Together with the net income from investments and services, the United States had available some $6 billion to meet government expenditure abroad, including military expenditure and official assistance of all kinds. Thus the only uncovered foreign payments were of a capital nature—private long-term investments abroad and the outflow of short-term funds. Toward the end of the year and in the early months of 1961, the net income from trade and services rose further and
was sufficient to cover practically all the long-term private investment abroad at the current rate, in addition to government expenditure abroad.

It was in this improving situation early in February that the President of the United States made his statement that steps would be taken to safeguard the value of the dollar, and that the dollar price of gold would be maintained. In addition, the President declared that “The United States has never made use of its drawing rights under the International Monetary Fund to meet deficits in its balance of payments. If and when appropriate, these rights should and will be exercised within the framework of Fund policies.” Assisted by reductions in discount rates in Europe and a determination to avoid any great decline in short-term rates in the United States, the outflow of short-term capital subsided, and, with certain advance repayments from abroad, there was a substantial improvement in the over-all balance of payments of the United States.

The U.S. trade balance was helped by the strong boom which continued in most industrial countries in Europe, as well as in Japan. Compared with 1959, these countries increased their imports by about 20 per cent in 1960, and this was sufficient to lift the volume of world trade by about 10 per cent. Even such a large increase in European and Japanese imports was not sufficient to raise the general level of raw material prices, which in fact slightly declined over the year. Since many of the less developed countries are dependent on the export of only one or two primary products, even a relatively moderate decline in the prices of these products may create difficulties in their balance of payments; and with only slender reserves to fall back on, many have turned to the Fund for financial assistance. Thus the general weakness in the prices of raw materials and foodstuffs has been reflected in the work of the Fund, which has had an unusually large number of transactions with the less developed countries.

**Operations of the Fund**

In all, 32 countries from all the continents of the world have received financial assistance from the Fund or have had drawing rights under stand-by arrangements during the period since our last
meeting. With the exception of the United Kingdom, all of these countries can be said to depend largely on the export of primary products. But the balance of payments difficulties which these countries have experienced have not as a rule been due solely to weakness in the prices of their export products, for many have also suffered from excessive internal demand connected with their own credit and fiscal policies. As long as the general level of prices on world markets was still rising, it was possible to expect that in the individual countries a certain amount of credit expansion would be absorbed by rising prices; but now that the general price level is more stable, an expansion of credit beyond the current requirements of the economy is likely to be reflected with little delay in a deficit in the balance of payments. In several cases, the situation has been rendered more difficult by the continued maintenance of complex and discriminatory exchange systems. With the widespread desire to establish or maintain orderly monetary conditions and to simplify exchange systems, Fund assistance has generally been requested in support of fiscal, monetary, or exchange programs and the assistance has been given in the form of stand-by arrangements. In fact, of the 22 countries which have drawn from the Fund during the past year, all but 3 have entered into stand-by arrangements.

It would clearly be impossible for me to discuss in detail all these financial operations of the Fund. I should, however, like to mention briefly a few which have had unusual features and which seem to me to be of particular interest.

First of all, I should like to say a word about the drawing and stand-by arrangement granted to Yugoslavia at the end of last year. A total of $75 million, together with substantial credits from the United States and a number of European countries, was made available to Yugoslavia in support of an extensive exchange reform and program of trade liberalization designed to strengthen the Yugoslav economy and to integrate it more closely with the world economy. The immediate drawing, of the equivalent of $45 million, was made in six currencies—French francs, deutsche mark, Italian lire, Netherlands guilders, sterling, and U.S. dollars. This was the first occasion on which a drawing was divided among a large number of currencies in accordance with the policy of diversifying the currencies to be used in drawings and concentrating on the currencies
of countries with strong payments and reserve positions. The drawing of Italian lire was the first that had been made in that currency.

The operation with Chile in February of this year also contained a number of special features. The financial difficulties created by the earthquakes in May 1960, and uncertain prospects for the world price of copper, led Chile to enter into a stand-by arrangement with the Fund for the equivalent of $75 million in order to help maintain its program of economic stabilization. At the same time, Chile drew Argentine pesos, amounting to a further $16 million, to be used in partial settlement of the balance accumulated by Argentina under the bilateral trade and payments agreement between the two countries, which had already been terminated in anticipation of the transaction. This was the first time that a Latin American currency had been drawn from the Fund, and the first time that the Fund's resources had been used directly to assist a member to terminate a bilateral arrangement in accordance with an Executive Board decision taken in 1955. In addition, Chile was the first country whose outstanding drawings and available drawing rights under a stand-by arrangement exceeded the equivalent of 100 per cent of its quota.

Four particularly large transactions—with Australia, Brazil, India, and the United Kingdom—have been carried out during the last five months. In these transactions the policy of diversifying the currencies to be drawn and concentrating on the currencies of countries in strong payments and reserve positions was continued.

With these large transactions and the many smaller ones, it is clear that the Fund has done much to assist countries, both large and small, which are endeavoring to diversify their production and generally to develop their economies, but which still depend mainly on the export of primary products. Insofar as such development is financed by long-term foreign capital, the actual use of these resources will normally be reflected in a deficit in the current account of the balance of payments. Provided that the other elements of the balance of payments are in equilibrium, this current account deficit would be matched by external financing, and there would then be no over-all deficit. When this has not been

1 Selected Decisions, page 71.
the case, requests have frequently been made to the Fund for financial assistance, and then the purpose of the assistance granted has been to help the countries concerned to put their over-all situation in balance. The three-to-five-year period for which such assistance has been granted has been intended to provide the time needed for the appropriate measures to take effect, and thus to relate the long-term development to the available long-term finance.

Turning now to the transaction with the United Kingdom last month, I would like to describe briefly the background of the international movements of funds which preceded it. I have already referred to the large movements of funds out of the United States last autumn and winter—partly to take advantage of high interest rates in Europe. A part of this flow went to the United Kingdom, where a construction boom and a marked increase in investment in plant and equipment had led to a substantial demand for finance and, consequently, to a high level of interest rates. The inflow of funds from the United States and other centers led to an increase in reserves, in spite of the deteriorating position of the current account of the U.K. balance of payments. The British Government used part of the increase in reserves to repay in advance the drawing made from the Fund in 1956, and also to reduce the Fund's holdings of sterling to 75 per cent of quota.

Following the statement made by the President of the United States in February, the outflow of funds from the United States was sharply reduced; but there was still a movement of funds into a number of countries on the continent of Europe, especially the Federal Republic of Germany, due at least in part to continued rumors about the revaluation of the deutsche mark. The revaluation of the deutsche mark and the Dutch guilder by 5 per cent early in March, however, gave rise to a new crop of rumors about further currency changes. All this proved very damaging to confidence, particularly in sterling, because of the deterioration in the current account of the U.K. balance of payments. The authorities in the countries concerned strongly denied the rumors, but to small avail. It was even believed that the Swiss franc would be revalued, despite the growing deficit in the current account of the Swiss balance of payments, to which the Swiss National Bank drew attention.
In this situation a number of central banks—members of the Bank for International Settlements in Basle, as well as the Federal Reserve System in the United States—decided to cooperate more closely in the spot and forward exchange markets and in the granting of credits. In this way, substantial resources were provided in aid of sterling, but this in itself did not arrest the outflow of funds from London. Steps were needed to remove the imbalance in the British economy and to obtain the external resources required while the steps were taking effect. Using, inter alia, certain powers proposed in the budget that had been submitted in April and voted in July, the British Government introduced toward the end of July a series of comprehensive fiscal and monetary measures, and certain other policies, designed to eliminate the deficit in the current account of the balance of payments without imposing any restrictions on trade or current payments and, in particular, to restore confidence in sterling at the existing rate of exchange. The measures adopted by the United Kingdom showed the Government’s determination to deal with both the immediate situation and developments over a longer period, particularly in relation to future budget expenditure and the level of costs.

In support of these measures, the United Kingdom drew from the Fund the equivalent of $1.5 billion in nine currencies: U.S. dollars, deutsche mark, French francs, Italian lire, Netherlands guilders, Belgian francs, Japanese yen, Canadian dollars, and Swedish kronor—the first time the last currency had been drawn from the Fund—and, in addition, entered into a stand-by arrangement for the equivalent of a further $500 million. The U.K. authorities announced that, of the amount drawn, the equivalent of some £200 million would be used during the following month or two for repayment of credits. This transaction with the United Kingdom was by far the largest ever entered into by the Fund; and in order to replenish its holdings of the currencies drawn, the Fund sold gold valued at $500 million to the countries concerned, in the proportion of one third of the U.K. drawing in each currency.

The six transactions which I have mentioned are noteworthy for the size of the amounts involved and other special features, but it would be a false picture of the Fund’s activities if it were concluded that the transactions with other countries have not also been of real importance. Perhaps the simplest way for me to indicate the wide...
range of Fund transactions is to enumerate all the countries which have received financial assistance from the Fund over the last 12 months...

It is of interest to note that 18 of the 20 Latin American Republics are included in this list. Over the years, Latin American countries have drawn the equivalent of some $1.1 billion from the Fund. With the equivalent of a further $400 million available under unused stand-by arrangements with 16 of them, it is clear that the Fund has played a significant role in assisting the countries of Latin America in their efforts to overcome financial and economic difficulties.

**Fund's Holdings of Currencies**

With all the activity during the past year, drawings on the Fund have totaled the equivalent of nearly $2.5 billion. So large a use of resources has had a marked effect on the Fund’s holdings of currencies suitable for transactions at the present time. Even after the replenishment of these holdings by the sale of gold at the time of the drawing by the United Kingdom, the Fund’s holdings of several convertible currencies are very low. In addition, it has to be remembered that there are open balances under stand-by arrangements equivalent to almost $1.1 billion.

It had, indeed, become apparent at the end of last year, at the time of the strong outflow of short-term funds from the United States, that if the Fund were faced with substantial drawings by a number of countries with large quotas, its available holdings of convertible currencies would in all probability be inadequate. This has been borne out by the experience of the last few months. The Fund can, of course, make use of its gold holdings, but these are not necessarily revolving, and once they have been used for the replenishment of currency holdings they may not readily be restored by repurchases in gold. Therefore, the Fund should generally be careful in the use of its gold and should take into account other possibilities for replenishing its currency holdings, for instance by the borrowing of particular currencies under Article VII of the Fund Agreement.

**Examination of International Monetary System**

However, borrowing of currencies is not a method of replenishment that can suddenly be improvised. For this and other
reasons, the whole complex of problems connected with such borrowing needs to be closely examined and brought to an effective solution. Consideration of these problems should be set against the wider background of the international monetary system. In the vivid discussions on the merits and demerits of the present system which have taken place in recent years and months, attention has largely been devoted to the tensions which may result from the international flow of funds in a world of convertible currencies. As you know, a number of suggestions have been put forward advocating more or less radical changes in the existing monetary arrangements. It has been valuable that these matters have been so vigorously discussed, and the first question we have to ask ourselves is whether the present system can be regarded as operating in a manner sufficiently satisfactory to be worth maintaining. If that question is answered in the affirmative, then we must consider whether any particular measures should be taken to strengthen the existing institutional arrangements so as to provide sufficient safeguards to meet any dangerous tensions that may arise.

On the whole, I believe the system has worked well. It would indeed be difficult to conclude otherwise in the light of the great gains that have been made in recent years. In the purely monetary sphere, external convertibility has been established for a broad range of currencies; and with the better distribution of reserves, there is an increasing measure of freedom for capital movements. There has been a parallel development in the ever-growing liberalization of trade and, under conditions of relatively stable prices, international trade has been increasing at an annual rate of about 4 per cent in recent years, reflecting by and large a corresponding rate of growth in world production. These are no mean achievements.

But in spite of these achievements there have been periods of tension and unease. I do not think that the movements of short-term funds from one country to another have impaired the financing of trade or the flow of goods, but it is largely the fears that these movements have aroused that have led to the questioning of the soundness of our present system. In some quarters, doubts have been expressed whether the system under which countries hold part of their international reserves in currencies (which is known as the "gold exchange standard") will work satisfactorily in the
longer run, and whether this system might not break down as it did in the interwar period. I do not think we need draw that conclusion, for it is important to remember that the currency failures which occurred in the early 1930's were caused not by inflation but by widespread deflation—by a fall in prices which made itself felt first in the United States and then in Europe. I am sure there will be no similar deflation now, for there has been such a change in the objectives of the authorities that sufficient measures would surely be taken to prevent such a calamity, if it seemed to be threatening. Secondly, in the 1930's the exchange reserves of many of the European countries had been acquired by large-scale short-term borrowing, and melted away when the short-term loans were not renewed; today, most countries are the true owners of their exchange holdings. A third difference is that the International Monetary Fund today stands behind the nations’ reserves, supplementing them within the framework of its principles and practices and working at all times to promote international monetary consultation and collaboration. There was no similar international agency in the interwar period.

Today two currencies, the U.S. dollar and sterling, are the main reserve currencies. There is no doubt in my mind that the authorities in the United States and the United Kingdom are determined to pursue policies which will ensure confidence in the stability of their currencies. Of the outstanding short-term U.S. liabilities, about two thirds are in the hands of foreign central banks and governments and the remainder is largely held by commercial banks and business firms. For sterling, the proportion is very much the same. There are thus substantial amounts of these currencies in private hands and, with convertibility, liquid resources owned by business firms and banks can now, with little or no difficulty, be shifted from one country to another. There is indeed no lack of international liquidity in private hands, but for this very reason it is important that there should be adequate resources in official hands to meet the possible impact of international movements of private funds.

Problems Facing the Fund

As indicated in the Report of the Executive Directors before you, the Fund has been studying, in the course of this year, a broad range of problems, some of general import and some of a more detailed
technical, legal or institutional character connected with this situation. It is possible to summarize the main issues that have been considered in the form of three questions. To begin with, what are the payments difficulties for which the Fund’s resources may be made available under its Articles of Agreement? Secondly, how can the Fund best use its resources to meet these difficulties? And, finally, what resources are required to meet the difficulties and are the Fund’s available resources adequate to do so?

On the first question, the Executive Directors have discussed the extent to which the Fund’s resources may be used for helping to meet those deficits in the balance of payments of members that go beyond the current account and are attributable, in whole or in part, to capital transfers. From a purely practical point of view, there is of course great difficulty in separating current and capital payments under a system of convertible currencies. After a thorough examination of the various aspects of the problem, the Executive Directors have clarified the understanding of the Articles of Agreement, and in that way eliminated any doubt, which had not already been dissipated by the practice of the Fund, that the Fund’s resources can be used for capital transfers, in accordance with Article VI and the other provisions of the Articles. If a country facing an outflow of capital were to turn to the Fund for assistance, the test to be applied by the Fund would be in accordance with its accepted principles, i.e., that appropriate measures were being taken so that the disequilibrating capital outflow would be arrested and assistance provided by the Fund would be repaid within a maximum period of three to five years.

The answer to the second question—how the Fund can best use its resources—must take into account the strengthening of the current position and reserves of several member countries and the increased number which have accepted the obligations of Article VIII. This has made possible the use of a much wider range of currencies held by the Fund, thus increasing the volume of its usable resources. The Fund has therefore sought to diversify the use of its currency holdings in such a manner as to ensure that transactions with the Fund, and their repayment, will be conducted in those currencies which will be most helpful to the world payments situation. In pursuing this objective, the Fund has been

guided increasingly by the principle that drawings should be made in the currencies of those countries that have a strong payments and reserve position, while it is to be hoped that repayments will generally be made in those currencies that can be strengthened by their use in this way. There are a number of technical and legal problems to be faced in evolving a satisfactory program for the use of a wider range of currencies in Fund transactions and repayments. Some have already been resolved; others will need further attention. A measure of the success already achieved is shown by the fact that during the last year drawings have been made in 11 different currencies.

As a result of sales of their currencies by the Fund, a number of countries have now acquired increased drawing rights because the Fund's holdings of their currencies have been reduced considerably below 75 per cent of quota. The Fund must always take account of the fact that, should there be a reversal in the payments position, the existence of these increased drawing rights could give rise to appreciable demands on the resources of the Fund.

I come now to the third question—the adequacy of the Fund's resources. It will be apparent from what I have said about the Fund's evolving policies on the currencies that should be drawn that the answer to this question cannot be settled simply by adding up the Fund's holdings of gold and currencies, or even gold and convertible currencies, at any particular time. What is important is to ensure that the Fund has enough of those currencies which it would be appropriate to use at any particular time, given the economic conditions of that time and the purposes for which it is appropriate to use the Fund's resources.

I have already referred to the fact that the intense activity over the last year has reduced the Fund's holdings of certain currencies to a very low level, despite the recent sale of gold. But this is more than a transitory problem confined to the present circumstances, and is more than just the question of the Fund's own liquidity. It is vital to consolidate and defend the system of convertibility built up over recent years, and to avoid the risk of any relapse into restrictions and currency disorder. In order that the Fund may play its part in this effort and meet the expectations of its members, it must be in a position to provide resources that are adequate
beyond doubt to meet any needs that may arise under its principles. And in a world in which market fears and expectations play a large role, resources—national and international combined—must not only be adequate to meet demands that may be made on them, but also large enough to convince the public that they are adequate to defend currencies from ill-advised speculation. A substantial reduction in the Fund's holdings of major international currencies could itself become a disturbing factor, long before the point of exhaustion is reached, unless there existed satisfactory arrangements for replenishing these holdings.

Borrowing by the Fund

All these questions have to be evaluated in the light of the swift changes in the balance of international payments that have occurred in recent years. In the circumstances, I cannot conclude that the composition and size of the Fund's resources are adequate to support a healthy international financial structure without further strengthening. The need for additional resources might be remedied by an increase in particular quotas, but in present circumstances I believe it can be handled more acceptably by firm borrowing arrangements. These would be concluded, in particular, with the main industrial countries, because of the major role they play in the swings in international trade and payments. This does not mean that other countries would have no interest in the conclusion of such arrangements, for the maintenance of a stable and convertible exchange system is as important to them as it is to the industrial countries.

Some problems arising from the use to be made of the Fund's borrowing powers under Article VII of the Fund Agreement have already been discussed in general terms by the Executive Directors, but many aspects still remain to be considered. An essential step in the conclusion of any borrowing plan is for the authorities in the individual countries to obtain the power to lend to the Fund if they do not already possess it. However, in my opinion, it would not be sufficient to leave the actual borrowing transaction to an ad hoc agreement between the Fund and the lending country under these powers. There is great merit in an assurance that additional resources are available to the Fund for its transactions. The ready
availability of resources is itself a contribution to stability and strength. It has time and again been the experience of the Fund that assurance to a member that it has access to the resources of the Fund under the provisions of a stand-by arrangement is in itself a stabilizing factor of great importance; often it has not been necessary for the member to use all, or indeed any, of the drawing rights thus assured. There is good reason to believe that the same sort of benefit would be obtained from credit facilities granted to the Fund.

At the same time, adequate provision would have to be made for general safeguards for the lending members. There would, of course, be consultation between the Fund and the prospective lender, and it should be part of the arrangement that the Fund would not borrow from a member country unless the country's payments and reserve position permitted this. Moreover, the arrangement would be such that any member that had lent its currency to the Fund would be able to obtain repayment readily if its own payments position changed. There would, of course, be no question of any weakening of the principles that the Fund has worked out for the appropriate use of its resources. These have stood the test of time in a great variety of circumstances, and we know that they are endorsed by the members of the Fund.

I believe that it should not be difficult to arrive at an agreement that will give due weight to the various aspects of borrowing, and thus to establish a workable system which would be beneficial and acceptable to all the members of the Fund. There are, however, a number of decisions of policy still to be taken.

As is said in the Annual Report of the Executive Directors, the approach to the increase in the Fund's resources by means of borrowing "looks beyond the immediate needs and endeavors to equip the Fund to handle flexibly the many and varied situations that may arise under a system of freely convertible currencies." 3

The Fund and Monetary Order

When we consider the Fund's role in the monetary system, it is valuable to keep in mind the two complementary aspects of the Fund's financial activities: on the one hand, the granting of

financial assistance by the Fund to help countries to meet an unbalanced position; on the other hand, the assurance that the country receiving the assistance will be taking the necessary measures to restore a proper balance. For such measures to be effective, it is indispensable that the authorities in the country receiving the assistance must be convinced that the restoration of the balance is in their true interest. As the Duke of Vienna said in “Measure for Measure,” the only play of Shakespeare to be set in this city of Vienna: “The satisfaction I would require, is likewise your own benefit.” It is precisely when this identity of interest is fully realized that the programs which are supported by Fund assistance can be carried out in a spirit of mutual confidence and the desired success achieved. For that result, the countries must feel that stability is essential for their welfare as the only true foundation for sustained growth. In taking this view, they can be encouraged by the evidence that those countries which have persisted in their efforts, and accepted the transitional difficulties of carrying out a stabilization program, have succeeded in staging an impressive rate of growth.

One of the requirements for economic progress is the availability for investment of real resources, and these cannot for any length of time be obtained by inflationary methods of financing. This is an old truth, but it seems that it has to be rediscovered over and over again. To obtain genuine resources requires, of course, effort. At the time when the richer countries are making considerable efforts to provide resources for the aid of the less developed countries, these countries in turn will have to make the maximum effort to mobilize their own resources, and, through stability, create the conditions for domestic and foreign resources to be used in the most effective manner. In creating these conditions, a great many countries have had the support of the Fund, and there can be no doubt that the Fund has thus contributed to the growth in production and trade that has occurred during the last few years.

All this seems clear enough, but I believe it is not convincing to all minds. While I think that nobody will want to maintain that sustained growth can be based on monetary disorder, there seems not seldom to be a lingering fear that stability will mean reduced economic activity, and even stagnation. It is true, of course, that stability is not enough, for the real national objective should be economic growth. Economic growth can be compared with the con-
struction of a good house, with stability as its foundation. A good house can only be erected on a solid foundation. Preparing the foundation, however, is not sufficient. There must be further initiative and activity, and the necessary resources must be acquired, to complete the building. In some countries, it seems that the restoration of monetary stability has almost by itself led to a resurgence of activity, and soon produced the savings to finance it. But this is not always the case; in many countries special domestic efforts are needed, and for these efforts to be effective they have often to be supplemented by international assistance, technical and financial. To introduce monetary stability is often only the beginning of the efforts needed to achieve growth. While the subsequent efforts fall largely outside the sphere of Fund activities, the Fund does not underrate their importance and, insofar as it can, is anxious to assist these efforts in every possible way.

Broadly speaking, the financial assistance given by the Fund helps individual countries to keep in line with general monetary trends in the world economy, while avoiding measures that would be disturbing to international trade. This is an important task, but it does not exhaust the scope of monetary action. Our monetary system has to serve an expanding economy. It is not suggested that credit measures alone can engender a high rate of growth; the fiscal and economic structure and the whole range of social and market practices are of vital importance. It may, for instance, be important to remove maladjustments due to mistaken budgetary policies, or in the cost and price structure, which would retard growth. The conditions under which foreign trade is carried on are also important—and with the new trading arrangements now being established, particular attention must be paid to these aspects. The Fund in its work is naturally interested in these questions, but pays particular attention to matters of monetary policy.

Under modern conditions, the gold flow does not set fixed limits to the possible expansion of credit or international liquidity. Within each country, the credit volume may be expanded in response to demand; and the monetary authorities can also take positive action to stimulate, and provide the basis for, credit expansion. Since World War II, on the whole, the problem has been to contain the expansion of credit rather than to stimulate it. All countries have been more or less involved in this process, but those countries
that are responsible for a high proportion of the world's production and trade must necessarily play a major role. They are aware, however, that even they cannot act independently of the general trend, and are therefore bound to act in cooperation with each other. Sometimes similar, sometimes complementary, policies will have to be pursued according to the ever-changing situation. The methods of cooperation will vary; there will be direct contacts, but there will increasingly be reliance on international institutions.

In Article I of the Articles of Agreement, which sets out the purposes of the Fund, financial assistance by the Fund is only one of the purposes. It is also the objective of the Fund to promote exchange stability and orderly exchange arrangements; to assist in the establishment of a multilateral system of payments; to facilitate the expansion of international trade, and thereby to increase the productive resources of members; and to act as a center of collaboration and consultation. Indeed, without the close contact between the Fund and competent authorities in member countries, it is difficult to see how any of the purposes of the Fund could be achieved. This has been proved time and again to be the case in the annual consultations with Article XIV countries. Already excellent results have been obtained in the consultations that have been begun with Article VIII countries. Here it is a question of voluntary cooperation, and for that reason I believe that these consultations will be more, and not less, effective. The cooperation has to be inspired by the notion that countries have a common interest as partners in the international monetary system. This system has to be strengthened where it is vulnerable; but the policies pursued must be such that the system plays its proper role in the process of economic expansion. To observe, on the one hand, the necessary monetary discipline, and on the other, to respond to the needs of expansion is no easy task. It raises many problems, but it is my impression that these problems are now being tackled more effectively than ever before with greatly increased chances of success.
The Monetary Background of International Finance *

While I am now going to speak to you about the monetary background of international finance, I should just like to say a few words here at the beginning about the monetary background, not only of international finance, but of our general cultural life.

In an article I wrote for a Swedish periodical in 1948, I recalled the fact that Athens, at the height of its glory in the fifth century before Christ, was a rich commercial city and maintained a currency—the famous silver drachma—which was kept practically stable for over a hundred years. 1 Two thousand years later, in Italy, the two Renaissance towns of Venice and Florence also built their fortunes on widespread commercial activities, and both, over long periods, maintained currencies noted for their stability. A few centuries later the Dutch towns, especially Amsterdam and Rotterdam, took up the lead in currencies and banking, and also in art and architecture. France emerged in the eighteenth century, in the age of enlightenment, as one of the richest nations and had for over half that century a stable currency. The following century—the nineteenth—was a century when the British influence was predominant and there was a spread of British methods and ideas in a number of different fields—parliamentary practices, trades unionism, central banking, economics, science (Darwin), social activities (clubs) and sporting activities (golf, football). And I need not remind you that the pound sterling was a trusted currency. But other nations too were as a rule able to maintain, up to 1914, sound money; and this was a century in which creative forces in the field of science and inventions, painting and literature ushered in modern society in a number of the principal nations of the world.

Pondering upon all these facts, we can hardly avoid concluding that high culture and stable money go together. It seems to be a


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lesson of history that without stable money neither justice nor progress can be assured, and that the human spirit cannot give of its best if it is harrassed by all the uncertainties to which rapidly changing money values give rise. Nations, too, must have their self-respect (which is something other than nationalistic pride) and enjoy the esteem of other nations; but this cannot be obtained without the benefits of a sound currency.

Importance of a Sound Currency

I mentioned the word “esteem” and I may perhaps here be allowed to tell you about a conversation which took place nearly four years ago in Paris. I had occasion to meet General de Gaulle a few weeks after he had become Prime Minister, which was as you know his first position after coming back to power in 1958. We had a fairly long talk alone in his office; he began the conversation as he used to do at the time, by telling visitors what his main goals were: how he would restore the strength and esteem of France after the period of bitter party fights and the rapidly changing governments that had led to disorder and misdirection and weakness; and that for this purpose he intended, he told me, to change the constitution to ensure a more orderly political life for the French people.

When the General had finished I said simply, “Mon Général, you spoke about restoring the esteem for France. I do not think that there will ever be esteem for a country that has a bad currency.”

He looked at me and replied, “Probably not”; and I went on to ask him if I might be allowed to tell him briefly the French monetary history of the last 150 years. It does not take a long time, I said, but it is very instructive. The General looked somewhat astonished, but I went on.

This is the story: In 1802 Napoleon gave France “the gold franc”—and this gold franc remained unchanged to 1914—to the outbreak of the first world war. It survived the two lost Napoleonic wars; the war of 1870-71; it survived the revolutions of 1830 and 1848; and all the changes of Government during the Third Republic. And the strength of the French nation showed itself during the terrible ordeal of 1914-18. “You see,” I said to the General, “the French are an intelligent and hardworking and thrifty people; and
if you give them monetary stability, they can stand a great deal of political instability. But after 1919 they have had both political and monetary instability and that is too much even for the French.

And I went on, adding: "Mon Général, I am sure you will do well to give the French a better constitution, but you never know: the French are awfully politically-minded. But if you could, like Napoleon, give a good currency to the French people, you would certainly have done a permanent service to France."

The General looked at me and said, "Je veux me rappeler ce que vous m'avez dit."—I'll remember what you have told me.

As you know, the French financial position was taken in hand; all current government expenditure was covered by current revenue, and a good deal of the capital expenditure also. Credit expansion was kept within proper limits—and, notwithstanding an adjustment to the external value of the franc, the rise in prices and wages was kept within narrow limits. The results have been quick and spectacular. France has gained foreign exchange sufficient to repay over $1 billion in debt and, in addition, accumulated a monetary reserve of about $3 billion. What this has meant for the strength of France, economically, financially and politically, I need not tell you.

I said that France has about $3 billion in monetary reserves. So has Italy; and the Federal Republic of Germany has $6 billion. These two countries—Italy and Germany—had earlier restored their financial strength. They had been through galloping inflation twice in a generation—and their peoples knew the value to be attached to sound money. An interesting question arose at the time of their monetary reform. In both countries there was unemployment—and the question was asked whether these countries by means of financial expansion at home should, so to speak, increase internal demand to reduce unemployment. This would have been, it was said, to follow Keynesian lines of policy, and there were many who recommended it. But the Italian and German Governments discarded this advice. They understood the essential difference between the period in the 1930's when Keynes wrote his General Theory and the period after World War II. In the 1930's there was a great depression with a worldwide lack of demand and stagnating foreign trade, and governments were, so to speak, thrown back on themselves. In the period after World War II,
on the contrary, the demand for goods and services was intense, prices were rising and those who could deliver the goods and services were certain to find customers. By holding back internal demand, by observing a high degree of monetary discipline at home, exports were stimulated; the increase in demand came from abroad, and the economies of these two countries became in that way export-oriented.

Great Britain had in several respects more difficult problems to solve than the countries on the continent of Europe; and British policies have, I think, been more vacillating than the policies of at least some of the countries on the continent of Europe. Since last summer, however, a very serious new effort is being made to correct a deficit in the balance of payments and ensure the enduring stability of the pound—with balanced budgets, credit restraint, and a wage pause. In the time that has passed since that policy was inaugurated, much foreign exchange has flowed back to London; and there are strong reasons to think that the policy will prove successful. Here again we find how monetary discipline is needed. No monetary system—be it the gold standard or a more managed monetary system—can work well without the observance of a proper degree of discipline.

If war is ruled out, as we hope it is, it will be more and more the economic and financial strength of nations that will determine their importance and influence in the community of nations. Monetary stability is a *conditio sine qua non* for such strength—and if Western Europe today is again a powerful part of the world, it is largely because in the crucial postwar years it understood this lesson. The Common Market, with its reduced tariffs and greater competition, has added to the discipline under conditions that give hope of continued expansion—to the great advantage of the participating countries.

The recovery of the economic and financial strength of Western Europe has, of course, affected other continents—particularly the United States. Europe can now compete and draw funds away from the United States, and the impact has been felt by the dollar and has led to concern. Measures have been taken in this country to safeguard the value of the dollar. The United States has had to learn that in framing its own policies it must take account of the consequences of those policies on its balance of payments, and
at the same time to establish increasingly close cooperation with other countries (especially with the countries in Western Europe) through direct contacts and through international institutions—the International Monetary Fund, the Organization for Economic Cooperation and Development (OECD), and the Bank for International Settlements in the monetary field, and in a wider financial field through the International Bank for Reconstruction and Development, the Development Advisory Group, and special consortiums as for India and Pakistan; and with the Latin American countries through the Inter-American Development Bank. This is a formidable array of institutions, which fortunately work in close contact with each other.

For my part I can only say that I am most happy about this closer monetary cooperation. I have no misgivings about international financial discussions outside the IMF. I do not regard the IMF in any way as omnipotent or as an exclusive agency in the international monetary world. The Fund has a particular role to play as the universal institution and as the agency provided with the more substantial resources, and it has been entrusted with certain powers by international treaty over exchange rates and other matters as no other institution has. Indeed, I welcome the greatest possible cooperation both inside and outside the Fund—and certainly within the framework of the Atlantic Community—on international monetary matters.

**Recent Monetary Achievements**

I think it would be useful now to say a few words about some of the more important recent developments—indeed some real achievements—in the monetary field. These developments themselves have, however, given rise to certain fresh problems, which have recently required and continue to require serious attention. There are, I would say, two major recent achievements. Firstly, a greater stability of prices, or what has also been called “the end of the postwar inflation.” The wholesale price level of this country, the United States, has shown no rise for three years, and sensitive raw material prices have rather been falling. The other achievement is the strengthening of currencies in the industrial countries which has made possible the establishment of the convertibility of all the main currencies with each other.
But what then are the accompanying problems? In the first place, when prices are no longer rising and are in fact kept down by the intense competition now felt on the markets not only for raw materials but also for manufactured articles, it is more important than ever to pay attention to costs. As long as prices could be raised it did not matter so much if costs were rising—but now an undue increase in costs can dangerously impair the working of the economy by slowing down economic growth and prolonging a high level of unemployment. If profit margins are continuously reduced, there may be less investment—perhaps idle savings—and certainly less economic growth. Consequently, the authorities in many countries have had to occupy themselves more seriously with this problem. Great Britain has recently announced a "wage pause", which has not perhaps been fully effective, but has had some real effect. Here in this country the Report of the Economic Advisers deals this year more fully with the wage problem than ever before, with the formulation of certain guidelines to be observed in wage negotiations. The tendency is evident even in the Federal Republic of Germany. Last month, Dr. Erhard, the German Economics Minister, told me that however much he liked a free economy, he now had to accept that the German Government would have to set forth some form of income policy. So you see how the end of inflation has created a problem of great importance in ensuring the proper working of the national economies and therefore also of the international financial system.

When I turn to the problems created by the other achievement, the convertibility of currencies, we move directly into the realm of international as opposed to matters more particularly of national finance. Since currencies have become convertible it has been much easier, and often more attractive, to transfer short-term funds from one country to another; and whenever a currency shows signs of weakness (or maybe is only "discussed" in the press and becomes the object of rumors), speculative movements of short-term funds are almost bound to occur. Even without such rumors, the very fact that the supply of credit in one market may be more abundant than in another may give rise to even quite substantial movements of short-term funds. In 1961 the export surplus and the income from invisibles here in the United States covered all foreign aid, all Government military expenditure abroad and also the greater part of long-term private investment overseas. The
so-called “basic deficit” represented by these items was only about $400-600 million. But the outflow of short-term funds in the form of credits and deposits abroad came to nearly $2 billion. Of this amount some has already come back—but it all shows how important these short-term movements can be.

Fortunately there are means of defense. The main industrial countries have, as I have already pointed out, quite substantial reserves. Moreover, central banks are now cooperating more readily to assist each other in case of need. There are also the resources of the International Monetary Fund, which can be used to assist member countries that take the steps to put their own house in order. The International Monetary Fund has at present $3 billion in gold assets, and $6½ billion in convertible currencies, these being very substantial amounts. But it may be, at a particular moment—for example, if there were to be a request for a drawing by the United States—that the Fund would not have enough of certain particular currencies, say, the currencies of countries on the continent of Europe. The Fund could replenish its holdings of these currencies by the sale of some of its gold—but the Fund’s gold holdings, if reduced, are not easily restored. The Fund has therefore taken the initiative to give effect to the power it possesses under Article VII of its Articles of Agreement to borrow the currencies of member countries. Under this Article the Fund has been able to borrow, but it was not much use to have this right if member governments had not the right to lend to the Fund. After long drawn out negotiations, which have taken the better part of a year, an arrangement has been agreed under which ten industrial countries have undertaken to lend to the Fund amounts of their own currencies amounting to the equivalent of US$6 billion. This sum, the total commitment of the ten countries, is available to assist any of those countries in order to avert a threat of impairment to the international monetary system. Of the $6 billion, a little over $2½ billion is the share of countries on the continent of Europe, $1 billion will be available from Great Britain, $2 billion from the United States and $450 million from Canada and Japan together. When these amounts become available, that is, when the agreement is finally ratified by the national parliaments concerned, which will soon happen, the Fund can meet requests from all its members, big and small.
It has been the experience of the past that sudden movements of short-term funds rarely attain an amount of $2 billion. In the case of the United States it may, of course, be more—but even speculators have not got unlimited funds at their disposal. It may be that the very knowledge that these new resources can now be mobilized to defend currencies will have a calming effect on the markets. As a matter of fact the exchange and gold markets have in recent weeks and months showed signs of more calm than for quite a time. My belief is that this is partly a result of a greater equilibrium in the international economic and financial structure, but partly also a result of a growing awareness that the authorities are now more determined to act in concert and forestall speculative pressures, as is evidenced by recent agreements for central bank cooperation and the International Monetary Fund's new borrowing arrangement.\(^2\) It may also reflect the hope of a certain improvement in the political situation, as is expected in the case of France and Algeria. There is much less demand for gold by those who hoard the metal, and the gold price on the London gold market has fallen significantly. Maybe it is only a lull between two storms—who knows?—but maybe also it is the first sign of the beginning of a more balanced relationship between the leading currencies. Achieving such balance would not mean that all problems are solved. The assistance that may be given by the International Monetary Fund serves to give more time to the assisted countries to take the proper steps to put their house in order. It gives time, but not time to waste. It helps to keep currencies in line—to preserve the existing monetary structure with its key currencies, the dollar and sterling, and stable exchange rates.

You are all aware, I think, of recent discussions about international liquidity. In themselves these borrowing arrangements of the Fund can add little to international liquidity over a period of years if more means of payment would be needed internationally. One reason is that assistance from the Fund has to be repaid within three to five years and is often repaid much more quickly. Since the war, as we know, there has been no lack of international liquidity, and there is certainly none today; and if less gold continues to be taken by hoarders, there will be more new gold available for the

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monetary authorities and thus for the expansion of world liquidity. But this may change. For the moment we in the Fund have heeded the saying of Franklin Roosevelt that "in politics one takes one problem at a time." The borrowing arrangements of the Fund do not exclude other solutions should they be required. I expect discussion of these matters will continue—but I hope it will be possible to pursue that discussion without the threat of an impending crisis.

**Stable Exchange Rates**

I mentioned a few moments ago "stable exchange rates." There can be little doubt that the maintenance of stable exchange rates is propitious to the arrangement of international financial transactions—especially long-term lending—but as you know there are economists who pronounce themselves in favor of a system of fluctuating rates. They believe that maladjustments in costs and prices may be so persistent that no true equilibrium can be reached between currencies unless exchange rates are allowed to move freely up and down. Now, we had a period of fluctuating rates in the 1930's but that was also one of stagnating world trade. Those who had to manage the system realized its great disadvantages—and in fact we have found in the work of the International Monetary Fund that even those countries that have not fixed an effective par value, but allow their exchanges to fluctuate, very soon seek to moderate the fluctuations and seek to sustain a measure of stability for the rate.

Looking back in history again for a moment, we find that in a great period of international financing (the 50 years before World War I—before 1914—which was the heyday of the gold standard), thanks to the rule of this standard, exchange rates were kept stable between most currencies in the world. The United States was then a borrower—so were some countries in Europe, including my own Sweden up to 1911, and so were a great number of other European countries, including, of course, the colonial areas. This was a period of tremendous expansion in world trade and international finance. I will only remind you that the volume of foreign trade in the world rose from a figure of about $5 billion in 1850 to $50 billion in 1910—and one can imagine what such a growth required in increased transport facilities and trade credits. We are now at the end of the era of colonialism, and the history of colonialism
will one day be written. It will contain some dark pages, but in the history of financing there will probably be less said about exploitation than of development. As in the United States now, most colonial areas could, before 1914, borrow at the rate of about 4 or 4½ per cent and sometimes even at a lower rate. Moreover, as the value of money fell during World War I, repayments were made in amounts of much less real value. I know that there are economists, like the late Professor Eli F. Heckscher in Sweden, who held that lending countries, and especially Great Britain, would have profited more from larger investments at home than by investing so much abroad. I argued with him at the time—this relates to a time over 30 years ago—but while I did not quite agree with him, I admit that he had some good arguments.

Some years after this discussion with Professor Heckscher, the same question was debated at a lunch table in the Bank of England. It was, I think, in the summer of 1937. The Governor, Montagu Norman, presided. I sat on his left, and on his right sat Lord Bessborough, then Chairman of the Council of Foreign Bondholders, which considers all questions relating to British foreign loans. Lord Bessborough had just reported to the Governor about the work of the Council of Foreign Bondholders over the last year and naturally told him about their difficulties—all the defaults and losses that were suffered at that time. Now it so happened that a report of the Bank for International Settlements, which I had written, had spoken in favor of foreign investments. Mr. Montagu Norman wondered how I could say such things in the face of all the sad facts. I pointed out that direct investments had generally maintained their value, and that the service of many loans was paid in full, but Montagu Norman continued arguing in his own peculiar, rather teasing, way. In the end I broke in and said that if it had not been for the foreign investments, the British would never have had their Commonwealth; they would not have played the role in the world that they have done; they might not even have had all the export industries which were built up in response to the demand following the foreign investment. And as a final argument I quoted, with a slight modification, the poet Tennyson, and said: "It is better to have lent and lost than never to have lent at all."

Yes, that is true up to a point: but if the losses are too great the lending will stop. One must not forget when one talks about aid
and loans to underdeveloped countries that the resources thus provided are either money from taxation or money from savings—in neither case easily come by. I still argue, as I argued with Professor Heckscher and with the Bank of England, that foreign investment is essential and needs to be continued in this world of ours, but that we have a situation of balanced responsibilities—the responsibility, on the one hand, of those who provide the aid and the loans, and the responsibility, on the other hand, of those who receive the resources thus mobilized.

Responsibilities for Capital Resources

I think the responsibility of the richer countries is being increasingly recognized. Personally, I think that as a yardstick these countries should aim at providing in various ways 1 per cent of their national income to aid the development of the rest of the world. That is not much compared with what we unfortunately have to spend on armaments, which can truly be said to be the White Man’s Burden in the present day and age.

But trade is more important than aid; what nations can earn is more valuable to them than any amount of loans or grants. Therefore it is part of the responsibility—and indeed in the true interest—of the richer nations to permit imports of the goods produced by the poorer nations. In the tariff reductions now being envisaged, a place should be found not only for the more ready admission of raw materials but also for better treatment of the imports of manufactured goods from the developing countries.

As far as the developing countries are concerned, even with 1 per cent of the resources of the developed countries and increased trading opportunities, only a part of their needs can be covered—and these countries have consequently to ensure that the resources they receive from abroad are used for the best purpose and that domestic savings are mobilized to the greatest possible extent. If these countries continue to inflate their currencies (covering, for instance, as quite a few have done, the deficits in their budgets with newly printed money), experience shows that the inflation will not stop at a modest figure of, say, 3-5 per cent a year but become galloping inflation with price rises of 20-30 per cent a year. When that happens, there can be no orderly progress in investment or generally in their economic life. And those who save in such a
country will often seek to export their capital, so as not to be deprived of the fruits of their industry and savings. In fact, the communists know that there is a clear choice between consumption and investment. They tell their people that there has to be austerity to set free resources for investment. They don’t talk about this in their propaganda to the Western world but they do not hesitate to apply this policy at home.

The Fund has achieved much, but there are still many troublesome problems unresolved; and there will be many difficulties in the future as the many new countries in Africa begin to expand and develop. There is, I think, some hope that those which have belonged to the sterling area and the French franc area will continue some of the old links, which can be a great advantage to them. When representatives of these new countries come to see me, we naturally talk about these matters. I try to tell them that monetary stability is a matter of great importance for their political independence and self-esteem. And when they wonder, as they sometimes do, if this is really the case, I repeat to them what I have said to many others—namely, some words of Benjamin Franklin, who in his homely language used to say: “Good finance is like a sack of potatoes, full of potatoes; it stands up by itself. But bad finance is like the sack without the potatoes; it lies prostrate on the ground.”

So I come back to some ideas I tried to express at the beginning of this talk. The question of the monetary background to international finance must be considered not in a narrow sense but in a broad sense. Questions of international finance are related to the strength of nations; and monetary stability is an element, I would say an indispensable element, in the maintenance of a country’s strength. Let me give you one final example.

**Stability and Social Progress**

The International Monetary Fund deals with all its member countries irrespective of their political orientation. We have had, as it happened, at much the same time important transactions with both Spain and Yugoslavia, two politically very different countries. I am sometimes asked whether I think it is right for the Fund to transact its business in this way. My answer is that, according to our statutes, it would be difficult—not to say impossible—to behave
differently. But even apart from the consideration of our statutes, I think that our behavior is the right behavior. Whatever the political orientation of the countries receiving help, when the Fund's assistance is successful it means that inflation is contained and usually that trade is liberalized and able to flow more freely. This means that the main beneficiaries are usually the middle classes. Even when inflation is very rapid, the very rich often find a way of safeguarding their interests; the very poor have not much to lose; but the middle class is squeezed. I saw this happen in Germany after World War I, with grave political consequences. To help the middle class of a country is to promote the stability of that country. In more developed countries—like the United States—the great mass of the people will be middle class, which is one of the reasons why there is here so much support for a policy aimed at maintaining the value of the dollar. In other countries, too, for technical and other reasons, the middle class is growing, and as this class gains in strength, countries may attain more political stability and be anxious to pursue—whatever the government—a progressive middle-of-the-road policy.

Such a policy will not exclude social progress, and the maintenance of sound money will not mean that for fear of inflation one should tolerate deflation. After the collapse of the New York stock exchange in the autumn of 1929, there was a period in the early 1930's when the old gold standard, for a number of reasons, did not operate as it had done before 1914; and as no new methods of withstanding deflation had really been developed, each country was obliged to act more or less on its own, to the disadvantage of them all. I think we have better methods now, and we have now more international cooperation in the financial field—more determination and a greater will to cooperate, so that proper solutions can be found to the many problems which arise in the management of the monetary system. It is necessary that much attention should be given to these problems, and I would go so far as to say that the ordinary citizen should take an interest in them. I mentioned earlier that, now that we have more stable prices, more attention has to be given to costs of production and thus to all questions relating to labor contracts. Our society has developed in such a way, with large and powerful associations of particular groups of people, that we cannot any longer expect the free forces of the market to
put everything right. There has to be more management, more negotiation, more deliberate policy making, to ensure that the market economy functions properly. With such matters lawyers will usually be concerned. I wish I could say that the circulation of money is like the circulation of the blood: when things go well one can forget about it. In questions of monetary management and all matters relating to it, eternal vigilance is needed. In this field there is not much that can be determined precisely in advance through legal enactments; most decisions will have to depend upon the judgment of all the circumstances at a given moment, taking account of the phase of the business cycle and many other matters. In the past, central banks were often very discreet and noncommunicative. They have learned that they have to enlist the interest of the public, and whoever wants to be informed about such matters is now in a position to read about them.

Personally, I think that by greater understanding of these problems it will be possible to pursue sensible monetary and related policies. It is, of course, of utmost importance for the system in the Western world that this should be the case. I cannot help taking some comfort from the borrowing arrangement now concluded by the ten nations with the International Monetary Fund. Most of the European countries had their difficulties: France in Algeria, the Federal Republic of Germany in Berlin, Italy with many still unemployed in the south, Belgium in the Congo, and the Netherlands in New Guinea—not to mention the British difficulties. But they agreed to take steps to make substantial amounts available in case of need. They did so in a spirit of monetary solidarity. It is true that assistance alone will not help; each country has to see to it that it puts its own house in order—which is not always easy. But here too there is more understanding, matters are taken in hand, not allowed to slip. And I am glad that more and more people, young as well as old, are taking a growing interest in these questions. Monetary matters are not a closed field. Our experience is continually widening and changing. Much is happening both nationally and internationally, and much more will happen in the future. Thus what is done to cope with the problems in the monetary field should be followed closely. The policies of those in whose hands the management of our monetary system rests are the concern of every person in our modern society, because it is one of the main foundations on which our modern society rests.
Looking back on more than forty years of international life, I can think of no period in international monetary affairs which has been so exciting, and at the same time so constructive, as the twelve months which have passed since I last appeared before you. The excitement began in fact rather more than a year ago, in the winter of 1960-61, when, as you know, the value of the dollar was under discussion, leading to considerable pressures on the exchange markets. One of the more spectacular signs of nervousness was the increased purchase of gold by the public in those markets where gold could be bought; and the prices paid in those markets, when converted into dollars, rose well above the official level of $35 an fine ounce. This particular phase, if not quite brought to an end, clearly gave way to a period of less strain, following statements made by President Kennedy early in February 1961 that the official dollar price of gold could and would be maintained at $35 an ounce, and that the United States authorities were determined to take whatever action was deemed necessary to correct the persisting basic deficit in the U.S. balance of payments. The relative calm proved, however, to be of short duration, for a new situation suddenly arose as a result of the revaluation by 5 per cent of the deutsche mark and the Dutch guilder at the beginning of March 1961. Whatever may be the contribution of these changes toward a lasting monetary equilibrium, their immediate consequences were highly unsettling. The financial world was plagued by rumors of further changes in the exchange rates of the deutsche mark and the guilder, and of changes in other European currencies. These rumors were greatly damaging to confidence. Considerable movements of short-term funds took place, affecting particularly sterling, a currency in which large working balances and reserves of many countries are held.

It soon became clear, however, that there was a determination in the major financial centers to defend the existing monetary struc-
ture, and this determination found expression in constructive action on the part of the various monetary authorities. Short-term credits of various kinds, which reached a maximum level equivalent to some $900 million, were granted by a number of central banks of continental European countries to the Bank of England. This gave the British Government time to work out a comprehensive program, announced to Parliament in July, to counteract these pressures on sterling. The United Kingdom then received substantial assistance from the International Monetary Fund; seven different currencies equivalent in all to $1,500 million were drawn, and a stand-by arrangement for a further $500 million was also concluded. The program of the British Government included special surcharges on indirect taxes aimed at achieving an over-all balance in the budget; bank rate was increased from 5 to 7 per cent and other measures taken to restrain credit; and a series of measures, including the so-called wage pause, was introduced, designed to moderate further increases in costs. The announcement of these measures in the United Kingdom, together with the massive Fund assistance, led almost immediately to a reversal of the trend on the exchange markets, especially as there was a pent-up demand for sterling held back during the period of uncertainty. But confidence is a plant of slow growth; and the disquiet affecting the whole exchange situation subsided only very gradually.

In fact, in many parts of the world the balances of payments continued to be exposed to a great deal of strain, and financial assistance from the Fund was requested by many countries. The reasons for the continued strain varied, but there is one major economic development which goes some way to explaining it and which is perhaps not immediately apparent. This development was what has been called "the end of the postwar inflation," which, like the greater convertibility among currencies, has in itself been a great achievement; but it has also posed problems. In the postwar period commodity prices had gone on rising, some years more, some years less; but by 1959-60, when the major currencies were convertible and trade had been greatly liberalized, supplies of goods had generally caught up with demand. Fortunately, booming business in Europe and improving business in the United States kept the general level of prices from falling. But within that general level, the prices of some goods and services rose while others declined;
and those countries that were largely dependent on the export of commodities of which the prices had declined, were often adversely affected. Moreover, once the general price level had ceased rising, greater attention had to be paid to moderation both in the field of cost increases and in the field of credit expansion. Since steps were not always taken in this new situation to bring about speedily enough the necessary adjustment in policies and practices that had been maintained over a number of years, unbalanced external positions emerged. A number of countries lost reserves, and many of these were obliged to turn to the Fund for financial assistance in order to gain the time needed for the corrective measures to take effect.

Operations of the Fund

All in all, drawings on the Fund over the last twelve months amounted to a total of $2.4 billion in ten different currencies, and at the end of that period, i.e., at the end of March 1962, undrawn balances of outstanding stand-by arrangements with members amounted to a total of $1.9 billion.

These are very considerable amounts and there can be little doubt that over the past year, which has seen a good deal of political tension, financial unrest, and economic disturbance, the use of the Fund's resources has made a significant contribution in helping to avert an impairment of the international monetary structure and generally in promoting economic progress. Despite all the rumors and large movements of funds, business cannot be said to have been impeded by any payments difficulties or lack of liquidity, and world trade has continued to increase. These more favorable aspects of world developments should not be overlooked in any general review of the last twelve months, for many of the reviews seem to me to have put perhaps undue emphasis on the forces of disunity in the world today.

Over the years it has been the experience of the Fund that the magnitude of its financial operations may vary considerably from one period to another. After drawings in 1957 amounting to the equivalent of approximately $1 billion, the years 1958 to 1960 were relatively calm, and drawings totaled only a few hundred million dollars annually. But in 1961 they rose to an amount of $2.4 billion. In that year new stand-by arrangements were also much
higher than earlier and totaled the equivalent of $1.4 billion. Clearly the Fund, as the central agency for monetary assistance, must be in a position to meet the exceptional demands of a very tense situation as well as the more normal needs of all its members, big and small. The general increase in quotas, which in 1959 added the equivalent of some $5 billion to the Fund's resources, was mainly designed to adjust the quotas to compensate for the increase in the level of prices by about 50 per cent which had taken place in terms of gold or dollars since the Fund began its operations in 1947. It was without doubt a very useful increase; if it had not happened, the Fund would hardly have been able to provide the assistance that it has been called upon to give over the last twelve months, for neither the drawing possibilities of the assisted countries nor the Fund's available resources would have been adequate to cope with the situation. The Fund, in fact, at one point last year replenished its holdings of certain currencies by the sale of $500 million of its gold; but as the amount of gold that the Fund holds is not very large compared with possible needs, and since amounts of gold which are paid to the Fund are normally only moderate, the Fund must be cautious in the use of its gold. For the sake of international monetary balance, Fund drawings should be mainly in the currencies of countries that have strong balance of payments and reserve positions; so the Fund ought to be in a position, should the occasion arise, to replenish its holdings of precisely those currencies without being obliged to dispose of its gold.

**Fund Borrowing Arrangements**

Very heavy drawings on the Fund, severe pressures on the exchange markets, only limited holdings of gold which the Fund could prudently utilize for drawings—these then were the background to negotiations which were undertaken last year with a view to improving the world's monetary defenses, and which resulted in the Fund's general arrangements to borrow.

As I mentioned in my address to the Economic and Social Council a year ago, the Fund was at that time considering the negotiation of credit arrangements with the main industrial countries under which the Fund would be able to obtain further amounts of their currencies for its operations.¹ Progress was made through

¹ See above, page 223.
discussions and negotiations in the course of the summer and the autumn; and early this year the Board of Executive Directors of the Fund reached a decision on general arrangements by which the Fund might borrow supplementary resources under Article VII of the Fund Agreement. This decision set out the terms and conditions under which such borrowing would be possible in order to enable the Fund to fulfill its role in the international monetary system under conditions of convertibility. Under these arrangements, ten of the major industrial countries will stand ready to lend up to specified maximum amounts of their currencies to the Fund, totaling in all the equivalent of $6 billion, whenever the Fund, together with these countries, considers that supplementary resources are needed to forestall or cope with an impairment of the international monetary system. In an exchange of letters among themselves, the countries concerned have set down the procedures they will follow in making these supplementary resources available to the Fund, should such resources be required by the Fund in order to help to finance a particular transaction. 

It is the great merit of these borrowing arrangements that they make it possible to mobilize quickly large additional resources for the defense of the international monetary system. The need for such resources arises not from any failure of this system, but, on the contrary, from its success—from the broader convertibility of currencies and the increased freedom of the exchange markets. As so often in life, success creates its own problems. More widespread convertibility, which is so important for the growth of world trade, has at the same time made possible sudden and substantial shifts of funds from one country to another. Since large movements of funds are most likely to occur between the main industrial countries, it was not unnatural that it was precisely those countries, in the first place, which wanted to provide adequate safeguards against the untoward effects of these movements. The resources to be provided under the borrowing arrangements will make it possible to forestall or cope with the threat of any impairment of the international monetary system created by these movements or by any other circumstances. Thus, the resilience of that system, as well as the liquidity of the Fund, will be enhanced to the benefit of all member countries. . . .

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The borrowing arrangements are to be seen as a manifestation of a growing tendency toward international solidarity in the monetary field. But these arrangements are not the only sign of such a tendency. I would like to mention again the credits, which I have already referred to, extended by various central banks on the continent of Europe to the Bank of England in the spring and summer of last year. It is also interesting to note that United States representatives are now attending regularly the meetings of the Bank for International Settlements in Basle; and that discussion of financial and monetary matters has become an important part of the work of the OECD in Paris. Furthermore, the Federal Reserve System is now in a position to undertake operations in the exchange market, and is in fact doing so, which certainly represents a new departure in postwar U.S. financial policies. The concerted steps being taken to prevent disturbing movements on the London gold market are also of interest in this context. I should add that these methods of cooperation are almost all still in the process of evolution, and none of them will, of course, replace the necessity for the authorities in the individual countries to safeguard their own positions and sustain balance by pursuing appropriate policies. But these national policies have to be worked out in relation to world-wide developments. It is a healthy sign that more and more discussions are taking place, either in international organizations or directly between interested countries, which contribute both to the adoption of appropriate national policies and to the harmonizing of these policies in the international field.

**International Payments Position**

I think that this working together has already met with a large measure of success. For some months now the exchange markets have been much calmer and singularly free from disturbing rumors. Sterling has, as you know, recovered from the pressures of the past year and is now strong in the markets. Furthermore, the British authorities have already to date repaid almost half the $1.5 billion originally drawn from the Fund in August last year. It has probably helped a little that most of those who last year speculated in gold and currencies burned their fingers, but that in itself would not be sufficient to steady the market. The relative calm is, I think, rather due to a growing feeling that in monetary matters there is a greater
measure of international cooperation and that sufficient resources are available both to overcome difficulties that may emerge and to ensure that public policies will not have to be determined by the impact of sudden movements of funds due to speculative attacks.

Certain basic developments in the fields of costs and credit also have helped to establish a better balance in the international payments position. In the past year money wages have risen to a much greater extent in most Western European countries than in the United States, while in the field of interest rates a decline, especially in short-term rates, in Western Europe generally has contrasted with their maintenance at a steady level in the United States. These developments do not solve all problems, but the effect has been to alleviate some of the pressures on the system.

In the foreign exchange field, measures have been taken in individual countries which may for the moment cause difficulties internally or externally, but which I believe will prove to represent an approach to a more balanced system. A development which aroused much interest and also criticism was the action taken by the Canadian authorities in reducing by about 5 per cent the exchange value of the Canadian dollar in June 1961, as part of their program to stimulate the economy. The Canadian dollar is not maintained at a fixed rate, but recently intervention in the market has moderated the fluctuations, and in the last two months quotations have ranged between 95 and 95 1/2 U.S. cents to the Canadian dollar. Two more recent developments in the exchange field also deserve mention. In January of this year the Philippine Government introduced a fluctuating rate for the peso, reducing very greatly previous multiple rate practices, and in February the Israeli Government, with the concurrence of the Fund, established a new par value for the Israeli pound of three Israeli pounds for one U.S. dollar. In both these cases the objective was to establish a realistic rate of exchange in order to provide a sound economic basis for foreign trade and better balance to the economy as a whole.

A glance at the list of countries with which the Fund has had transactions over the last year makes it clear that the majority of the Fund's transactions has been with the less industrialized countries. This is nothing new: since its inception most of the Fund's transactions have been with the less developed countries. I find there is sometimes a tendency to discuss the problems of nonindus-
trialized or less developed countries as if these countries were all in the same position. In fact, the less developed countries differ very considerably with regard to their rate of development, the effectiveness of their institutions, the strength of their traditions, and the possibilities of mobilizing resources for continued progress.

Most less developed countries have, however, one thing in common: they want to enhance their possibilities of development by access to resources from abroad. They have found that they could develop faster if they supplemented their domestic savings with foreign capital. A considerable part of the resources from abroad has been obtained by way of loans issued in foreign capital markets or through investments of private foreign firms, but a great many of the less developed countries rely to a great extent on aid and loans from official sources. They too, however, find that they need an inflow of private capital to help them in their development. For external, therefore, as well as for internal reasons, all these countries are well advised to establish and maintain a high degree of creditworthiness. Now, in any judgment of a country's creditworthiness, one of the major considerations will always be whether or not that country maintains stable monetary conditions. But of course monetary stability is much more important for a country than simply its effect on the thinking in foreign financial centers from whence development funds are drawn. Monetary stability is one of the most important prerequisites of a healthy domestic economy and is, indeed, the only reliable foundation for sustained economic growth.

Effects of Inflation

In their efforts to develop their economies as rapidly as possible, one of the great problems with which so many countries have had to contend has been the pressure leading to continued inflation. I do not think that I need devote many words here to the terrible evils of continuous inflation, although there are those, as we know, who question the view that inflation is always harmful. Is it not a fact, they ask, that credit creation—even if inflationary—has led to development, while implementation of a stabilization program usually brings with it a period of stagnation? That is what they say.

It is true that for a time inflation can bring forth real resources, by a kind of "forced savings," but these savings are derived from
those whose consumption is reduced by the rising prices, i.e., through what amounts to exploitation, since the benefits accrue to others. This method of producing savings will not last for long, since those who are exploited will not allow their wages to lag behind, and the public will not continue to hold, for longer than they absolutely must, a currency that persistently falls in value. All kinds of distortions in the economy will ensue, quality of products will suffer, and the maintenance of capital assets already produced will be neglected. The resources that inflation has wrung out of a part of the population by “forced savings” will often tend to be used for unproductive purposes, luxury building, and the like. The new capital so obtained may even be more than outweighed by the flight of capital out of the country. So, there is a deterioration—for a time perhaps not fully noticed—which offsets the more spectacular gains financed from inflation. Meanwhile, monetary reserves are steadily eroding away, the public becomes increasingly critical, and eventually the authorities are obliged to reverse inflationary policies if major disturbances are to be avoided.

In addition, I wish to draw attention to one particular danger, that of an overvalued currency, that often arises in cases of inflationary financing of budget deficits or excessive private business demands for credit. Since such credit expansion will swell the volume of demand beyond available resources, internal prices will tend to rise, and also the volume of imports, while exports will be impeded and there will, in addition, be a flight of capital. For a time the inflation may engender a “boomlet” or a boom, but if the exchange rate is kept unaltered, as is usually the case, the economy will soon be caught by the depressing effects which arise from an overvalued currency. In the years 1931 to 1936, I was living in Switzerland, which, rich country though it was and is, suffered increasingly from sluggish business and growing unemployment as a result of the overvaluation of its own currency—in this case brought about by devaluations of other currencies. But even when an overvaluation is indisputable, there is often strong opposition to any move toward establishing a more realistic exchange rate. It is feared among other things that the rise in the price of certain imported goods following the adjustment of the exchange rate will be politically unpalatable; but as experience proves, the effect on prices generally is often slight indeed, since the new rate is some-
times little more than an adjustment to an already established price situation. It is the contradiction between the internal policy of excessive credit expansion and the external policy of keeping a pegged exchange rate that, in these cases, becomes so damaging.

If after a period of inflation a stabilization program is put into force, there will be a period of adjustment when monetary reserves have to be replenished and investments wait for genuine savings to become available. Usually the authorities will have to take certain major policy decisions which will not as a rule be popular. Successful stabilization requires determined effort and dogged perseverance on the part of the authorities, but if it is successful the results are lasting and valuable. During this intervening period of adjustment, when the necessary determination may be so difficult, the hard things, although they can never be altogether avoided, can be mitigated by foreign assistance.

I think it is true to say that the public, certainly in Europe and I think increasingly elsewhere too, has become more and more dissatisfied with the consequences of inflation, although it may still be unwilling to accept all the measures that are needed to contain the inflation. This is a situation which demands resoluteness in the formulation and implementation of policies, and also readiness to explain, with all the means of communication now available, why certain policies are necessary.

**Stabilization and Growth**

At this point, the question is generally asked whether one can be sure that the period of adjustment will soon be transformed into a period of growth. The stabilization programs undertaken with Fund support have met with criticism from those who describe them as deflationary and leading to stagnation. But countries which have pursued, without wavering, the consistent policies required to make a success of stabilization programs have found before long that the expansionary forces inherent in the economy have been strong enough to stage an impressive revival of business once monetary stability was restored.

But monetary stabilization in itself is not generally enough. While I have seen countries where the restoration of monetary confidence proved sufficient to give a start to an impressive economic expan-
sion, I am convinced that in many other cases similar results will not ensue without further action. . . . In the sphere of economics, monetary stability is a firm base on which technical knowledge and genuine financial resources may build. In the less developed countries, as elsewhere, technical efficiency and capital for development are both needed. Both will largely have to be provided from domestic sources, but foreign assistance can be of great help. It is one of the more hopeful aspects of the era after the Second World War that ways and means have been found to make such assistance available from abroad.

As far as the International Monetary Fund is concerned, its main task is to extend financial assistance to countries in order to provide them with the time they need while corrective measures take effect to strengthen the domestic economy and restore equilibrium in the balance of payments. The Fund readily grants assistance up to the limit of the gold tranche and the first credit tranche, corresponding as a rule to 50 per cent of a country’s quota, provided that the member country itself is making reasonable efforts to solve its problems. For assistance beyond this limit, the Fund’s scrutiny becomes progressively closer. Assistance is then granted in support of a comprehensive program aimed at establishing and maintaining an enduring stability of the member country’s currency at a realistic rate of exchange.

These principles and policies, which in the main were laid down in 1955, were elaborated in 1957, and restated in 1959 at the time of the enlargement of the Fund’s resources through increases in quotas, and have been reconfirmed in connection with the general borrowing arrangements. They have stood the test of consistent practical application over the years, with considerable success in relation both to developed and to less developed countries. By means of these policies and practices, the Fund has reached a fair balance of interests, in that members in need of assistance are assured that they have a second line of reserves, and the Fund has the assurance that its resources will be used to contribute to the orderly growth of international trade, to the main-

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tenance of a high level of employment, and to an increase in real income among its member countries, which objectives are some of the main purposes of the Fund.

The assistance of the Fund is granted for balance of payments reasons and is repayable when the member’s problem is solved and in any event not later than three to five years after each drawing. It is the responsibility of other institutions and of the richer countries to provide resources for longer term purposes—in particular, investments for development projects calculated to promote growth. It is not for me to comment here on the needs and possibilities in this field, except to say that quite a lot is being done. Complete up-to-date statistics are not yet available, but the 1960 figures show that the flow of resources from the industrialized countries of the West to the less developed countries exceeded the equivalent of $7 billion, which was somewhat in excess of the sum provided in the previous year.

Freedom of Trade

The provision of financial resources is not the only way in which assistance may be given to less developed countries. Trade as well as aid is important to these countries. It is part of the responsibility—and, indeed, in the true interest—of the richer and more highly developed nations to permit and encourage imports of the goods produced by the less developed countries. In the tariff reductions now being envisaged, a place should be found not only for the readier admission of raw materials but also for more favorable treatment of the imports of manufactured goods from the developing countries. May I say here that I am very much impressed by the steps being taken by European countries to reduce trade barriers, and by the proposed Trade Expansion Act here in the United States. These are wise and farsighted policies, pursued with great determination by great and powerful countries, and provided that they increasingly take into account the interests of the less developed countries, they can greatly contribute to a general growth of world trade.

Casting back in history, I fail to find any case where a country has not benefited as a result of the introduction of greater freedom of trade. There may be difficulties to be overcome and relief may have to be granted in special cases, but one cannot deny the
beneficial effects of such action. These recent measures and proposals can reasonably be regarded as a reflection both of good will and of enlightened self-interest. They represent in the field of trade and commerce the complement of the measures of greater international financial and monetary cooperation (of which the general borrowing arrangements of the Fund are one example) and are in their field part of the constructive policies of our times.

Reductions in the barriers to world trade may be expected to increase effective competition and thus be a safeguard against inflation; on the other hand, the increase in demand that is the concomitant of more trade should have a steadying effect on raw material prices. This latter effect is important for all countries, but not least for the primary producing countries, which continue to be subject to fluctuations in the value of their exports as a result of ups and downs in business activity in the industrial countries, and partly too as a result of the vagaries of nature in individual areas. The fundamental solution to the uncertainties which these fluctuations inject into the economic life of these countries lies in stable growth in the main industrial countries and a wider diversification of production in the primary producing countries. Substantial progress in both these objectives has been made in the last decade. And when temporary difficulties have arisen, many of these countries have drawn from the Fund; or, while using their own resources, have felt more secure through being able to rely on a stand-by arrangement or the general knowledge that they would be able to draw on the Fund if necessary. I would also refer to the various proposals which have been advanced during the last few years with respect to other possibilities of compensatory financing of the export fluctuations of primary producing countries. They form part of the efforts evident in many quarters to find ways of meeting the needs of the less developed countries.

International Liquidity

By its activities over the last year the Fund has been able to contribute greatly to the stability of exchange rates; and with more resources becoming available in case of need, the Fund should be able in the future to help effectively to strengthen the international monetary structure. But in addition to the question of stability of exchange rates, there has, as you know, been another question
greatly discussed in recent years, namely, the necessity of ensuring sufficient liquidity for the proper working of the international monetary system. This is a complex problem with many facets, but before I close I do want to touch on just one particular aspect of this problem.

Trade and production in the world, it should be remembered, are financed in national currency; and so it is the ability of each individual country to make credit safely available in its own currency which constitutes the true measure of its possible contribution to world liquidity. But as far as international trade is concerned, the availability of credit in the main industrial countries is of prime importance. From a practical point of view, the problem of world liquidity today is largely one of the capacity and readiness of the industrial countries to provide credit and sustain an adequate volume of means of payment. The ability and readiness of those countries to do so is, of course, influenced by the size and movements of their monetary reserves. Fortunately, most of these countries already have substantial reserves, while the possibility of access to the Fund's resources strengthens their position even further and enables them to pursue, in cooperation with each other, the policies that at any given time are appropriate to the situation.

Each individual country has thus to be mindful of the relative strength of its own position and has to take such action as is necessary to sustain that position. But from time to time there may also be a need for general concerted action to meet new problems as they present themselves.

Such matters are, of course, being discussed throughout the world in various organizations by the financial authorities of different countries. The Fund is one of the principal centers for international cooperation where the task of formulating policies for such concerted action can be undertaken. It is in the interest of all countries that these matters should be widely discussed in relation to both immediate and long-range problems. I think that great progress has been made in the past year in establishing and consolidating the necessary contacts and generally strengthening the machinery for cooperation in the international monetary system.

Such steps as already have been taken in developing that system, as for instance the Fund's borrowing arrangement, do not, of course,
close the door to future measures that in due course may be found appropriate. Attention must naturally be concentrated, in the first place, on the difficulties which are of immediate concern today, but the spirit of broad and willing cooperation evidenced among nations in recent months in these matters justifies confidence in their ability to find constructive solutions not only to present problems, but also to those which the future may hold in store for us.
Annual Report, 1962 *

It was at the end of 1958 that fourteen Western European countries decided to establish nonresident convertibility. The Governors’ Meetings in 1959 and 1960, as well as the Executive Board and the staff of the Fund in these years, devoted a great deal of energy to examining the implications of the move to convertibility for the international monetary system and for the activities of the Fund. Intensive discussions were held in 1960 with a number of countries that were considering the assumption of formal Article VIII status. These resulted, in February 1961, in ten member countries in Europe accepting the obligations for convertibility of their currencies as set forth in Article VIII, which meant that thereafter the great bulk of international transactions were being conducted in currencies which were convertible under the Fund’s Articles of Agreement. The Governors, particularly at the 1960 Annual Meeting here in Washington, had directed great attention to the new conditions arising from the return to convertibility. In the months following that Annual Meeting, the whole complex of problems referred to in the speeches by various Governors was very closely examined by the staff of the Fund, and on February 10, 1961 I made a statement in the Board of Executive Directors on the future activities of the Fund, as affected by these new conditions. The problems discussed in that statement related to (1) access to the Fund’s resources; (2) policies on the use of the Fund’s resources; (3) currencies to be drawn; (4) replenishment of the Fund’s resources through borrowing; and (5) capital transactions. In the year and a half that has passed since that statement was made, decisive progress has been made under each of these headings, as I shall now briefly report.

Policy on the Fund’s Resources

As regards access to the Fund’s resources, I believe that there has by now been sufficient experience to show that a country facing
balance of payments problems, whether or not of an emergency character, can confidently turn to the Fund for assistance, and that financial institutions and, indeed, the exchange markets regard this as an appropriate course of action, and an effective basis for the support of the country's currency. The Fund has not been reluctant in such circumstances to take the lead in assessing the country's economic and financial situation, and thus to provide an internationally recognized form of initiative and decision. On a number of occasions its own assistance has been supplemented by credits made available from other sources, and this has certainly been welcome. But, however useful the Fund's initiative may be, each contributor must form its own judgment of the adequacy of the measures proposed by the country concerned, and determine what credit facilities it is willing to extend.

As to the use of the Fund's resources, the policies and practices laid down for the use of those resources have stood the test of practical application. It was specifically stated in the Report on the Enlargement of the Fund's Resources (page 7) that the principles and practices on the use of the Fund's resources should not be changed as a consequence of the increase in quotas then envisaged, and these same principles and practices, after a further test of time, have been reconfirmed in the provisions of the borrowing arrangements, adopted by the Executive Directors in January 1962, to which I shall presently refer. The 1958 Annual Report (page 12) emphasized that the Fund's policies must, at the same time, be alert to the needs of changing circumstances. As an example, I might mention that whereas until recently financial assistance from the Fund had not gone beyond a total amount equal to 100 per cent of a member's quota, the Fund has now in several cases granted, or agreed to grant, assistance beyond that amount, up to 125 per cent. In this and in other matters under the Fund's charter, I am reminded of what an English Lord Chancellor, Lord Sankey, said of the Canadian Constitution. It was, he said, "a living tree capable of growth and expansion within its natural limits."

If I may depart from the order of the points I mentioned earlier, I would now like to refer to the relation of the Fund's assistance to capital transactions. While the experience of many countries has shown that capital movements may be substantial even under

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1 Annual Report, 1962, page 239; Selected Decisions, page 60.
systems of exchange restrictions, such movements can naturally assume even greater proportions under conditions of convertible currencies. Although the Fund’s resources had been used in situations involving capital transfers, there had been some uncertainty as to the extent to which, or the circumstances in which, the Fund’s resources could be used for helping to meet those deficits in the balance of payments of members that go beyond the current account and are attributable in whole or in part to capital transfers. This uncertainty had arisen largely because of doubt as to the implications of an early Fund decision on this matter. I recall that it was following a very useful suggestion of yours, Mr. Chairman, that the Executive Directors decided that it was necessary to clarify this whole matter. By a decision of July 1961, they were able to eliminate any doubt which had not already been dissipated by the practice of the Fund, that the Fund’s resources can be used to alleviate pressures brought about by capital transfers, in accordance with the criteria of Article VI and other relevant provisions of the Fund Agreement. Thus, if a country facing a disequilibrating outflow of capital were to turn to the Fund for assistance, one of the criteria which the Fund would apply would be to satisfy itself (in accordance with accepted principles) that the appropriate measures were being taken to overcome the balance of payments difficulties, and that the assistance provided by the Fund would be repaid at the earliest opportunity, and in any event not later than three to five years after the drawing.

It has, in fact, proved very useful that this matter was clarified, since in some recent important transactions of the Fund, capital transfers have been responsible for a considerable part of the pressure on the currencies which were supported. I need only mention the important Fund transactions in 1961 and 1962 with the United Kingdom, South Africa, Mexico, and Canada. In each of these cases, the outflow has proved to be speedily reversible, thus confirming the Fund’s judgment that the conditions laid down in the Articles of Agreement were entirely fulfilled.

Borrowing Arrangements

Turning now to the question of the replenishment of Fund resources by borrowing, the negotiations which were conducted

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after the Annual Meeting in Vienna last year led to arrangements under which the Fund will be entitled to borrow, under Article VII of the Fund Agreement, supplementary resources in the currencies of ten member countries, amounting to the equivalent of $6 billion in all.\(^3\) . . .

I am glad to be able to report that the acceptance of the proposals for participation in the borrowing arrangements in the various Parliaments has been virtually unanimous, and this, I think, may be regarded as a recognition of the importance of these arrangements as a significant means of strengthening the world's monetary structure. The ten industrial countries which are partners to these arrangements are among the countries most likely to be affected by substantial short-term capital movements, and it is therefore natural that they in particular should have wanted these supplementary resources to become available in case of need. However, all Fund members have a fundamental interest in these arrangements because these are designed to enable the Fund to fulfill more effectively its role in a world of more and more convertible currencies. Moreover, the possibility of using supplementary resources to help to finance large Fund transactions will enhance the Fund's liquidity, and enable it to cope with other transactions within the framework of its basic policies. As soon as the borrowing arrangements have entered into force, which I am confident will be a matter of only a few days or weeks, the Fund will be even more clearly in a position to meet requests for financial assistance from all its members—large and small—even in situations when there are very substantial capital movements. It will thus be able to provide the time for the proper policy measures to be taken and to take effect in individual countries. Already, it seems, knowledge that substantial resources may promptly be mobilized if and when required has had a calming effect on the exchange markets, so that the coming into force of the borrowing arrangements, together with other useful measures and developments, has cast its shadow before it.

**Selection of Currencies to Be Used**

Finally, on the question of currencies to be used in Fund operations, I would like to refer you to pages 36 to 41 of the Annual

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Report, where there is reproduced the statement adopted by the Executive Directors on July 20, 1962 on the appropriate currencies to be used in Fund transactions and in the repayment of sums drawn from the Fund. This statement is a considered recognition of a very important development over recent years, in which the spread of convertibility has made possible a broadening of the range of currencies usable for drawings and repurchases, and has thus led to a great increase in the liquidity of the Fund. At the moment, after large repurchases by the United Kingdom and a very substantial net inflow of dollars into the Fund, the Fund's holdings of dollars and sterling are close to 75 per cent of these countries' quotas, which means that the Fund's transactions now outstanding have their counterpart (apart from net sales of gold over the years) mainly in creditor positions of European currencies. By paying close attention to the balance of payments developments of the countries concerned, the Fund has increasingly been able so to arrange the currency composition of drawings and repurchases as to take account of these developments and, for example, to offset short-term and sometimes speculative capital movements over the exchange markets. In this way it has contributed significantly toward achieving a more balanced over-all reserve position. Since the amount moving in and out of the Fund over the last two years has amounted to $5.5 billion, the aggregate effect has been not inconsiderable.

The statement of the Executive Directors on currencies to be drawn and to be used in repurchases represents, to a great extent, a confirmation of practices which had been developed over the past few years. It is, however, expressly noted that "These practices are still in a state of evolution as increased experience is being gained." It is my belief that the same observation can be applied to a wider range of Fund activities, and even to the Fund as a whole. There has been, and will continue to be, in the Fund a lively awareness of changing world conditions as they affect monetary practices and policies, and I believe the Fund will continue to show the ability to cope with new developments as they emerge. Care has been taken to ensure that the arrangements made and the practices that have evolved have been consistent with the provisions and pur-

4 Selected Decisions, pages 33-49.
poses of the Articles of Agreement; experience has shown us that these Articles, to a greater extent than is perhaps generally realized, serve as a basis for progressive action. Thanks to this experience and to the good will which has been shown by member countries, the effectiveness of the Fund has been greatly increased. For this to be done, much work and painstaking negotiations have been necessary, but results have been achieved which are within the range of practical politics.

_Fund Transactions_

In the meanwhile, within the framework of these developing principles and practices, the Fund has continued to engage in a large number of transactions with member countries. In the twelve months preceding the opening of this Meeting, no fewer than twenty-six members have received financial assistance, either through direct purchases of currencies or in the form of stand-by arrangements. . . . Total purchases of currencies amounted to the equivalent of $678 million, while total repurchases were equivalent to $1,749 million. Under new stand-by arrangements granted by the Fund in the period, an amount of $1,579 million remains undrawn. The high figure for repurchases is largely explained by the fact that the drawing of the equivalent of $1.5 billion by the United Kingdom was repaid in full to the Fund within less than a year from the date of the drawing. As a precautionary measure, a new stand-by arrangement of $1 billion for one year was agreed to at the end of July, but it has not been drawn upon. Also as a precautionary measure, Japan in January entered into a stand-by arrangement for $305 million, no part of which has so far been utilized. A third industrial country which turned to the Fund in the course of the past year was Canada. First, early in May, it sought the Fund's concurrence in the establishment of a new par value for the Canadian dollar, after a period of ten years during which Canada had maintained a fluctuating rate system; and then in June, at a time of great pressure on its currency, it obtained a drawing from the Fund equivalent to $300 million. Simultaneously, Canada obtained from other sources the equivalent of a further $750 million, and all this assistance, together with the domestic measures taken, proved sufficient to reverse the trend on the exchange market, and has enabled Canada to replenish its foreign exchange reserves in an impressive way. . . .
Other Functions of the Fund

The variegated activities of the Fund are, of course, by no means limited to the granting of financial assistance; they are all fully described in the Annual Report which is before you, but I would like to mention just a few.

In the first place, the Fund has jurisdictional powers with regard to par values and rates of exchange. I have just mentioned Canada's new par value. Israel in January this year, after detailed discussions with the Fund, also adopted a new par value, discarding its previous system of complex multiple rates. It did so without requesting the financial assistance of the Fund, being confident, as developments have borne out, that its reserves would steadily increase after the new par value had been fixed.

Secondly, the annual consultations under Article XIV of the Fund Agreement, as well as those which are now conducted with Article VIII countries, form a very considerable part of the Fund's work. . . . It is difficult to imagine how the Fund could act so speedily, as it has repeatedly done in response to requests from its members, including requests for financial assistance, if it were not in possession of the information obtained through these annual consultations. Moreover, the consultations make it possible to form an over-all view of the world's economic and monetary problems, which is as essential for the proper policy decisions by governments as it is for the proper conduct of the Fund's work, not least in furthering the general purposes laid down in Article I of the Fund Agreement.

Finally, in the field of technical assistance, in addition to the annual consultations, the Fund has over the last year provided technical advice and assistance to a large number of countries through resident advisors and in other ways. Such assistance has, indeed, in several cases been extended to countries which have applied for membership but have not yet become members of the Fund—one important case being that of the Congo, where the staff has been frequently consulted on a wide range of financial problems. In this connection, too, I should mention the Fund's expanding training program, under which officials from member countries attend courses of instruction provided by the Fund in its special spheres of activity. The contribution which the Fund can make in the field of training is a considerable one and capable of
further extension in years to come, to the particular advantage, I think, of many new members.

It is one of the advantages of the Fund that its financial assistance can be pinpointed precisely to those situations where difficulties in the balance of payments occur. The assistance helps the countries to take corrective measures and also helps to avoid the emergence of a chain reaction, which could set in if the situation were not taken in hand. These are both real contributions toward ensuring stability in the world’s monetary system, and toward the maintenance of an adequate level of liquidity.

*Exchange Stability and Liquidity*

The twin problems of exchange stability and adequate liquidity have continued to be widely discussed in economic circles over the past twelve months. In these discussions I think it has been widely recognized that, at the moment, the facilities available for the financing of world trade, and the use made of these facilities, have been broadly satisfactory. After all, the value of world trade in the first half of this year was no less than 6½ per cent higher than in the corresponding period of last year, and this could surely not have happened had adequate financing not been forthcoming. World trade is of course financed by credit in national currencies, very largely in the two reserve currencies, the dollar and sterling, but also in other currencies. It may be mentioned in passing that the so-called Euro-dollar and Euro-sterling markets have certainly made a contribution to the financing of transactions in the field of foreign trade, and from that point of view have been distinctly useful.

The kind of liquidity so far referred to is in terms of national currencies. There is, however, another concept associated with the term liquidity (economic terms are unfortunately rarely unambiguous), and that is the concept of international liquidity, which is concerned with the magnitude of monetary reserves, that is, the holdings of gold and foreign exchange by the various monetary authorities.

For some time there has been much discussion whether or not there is an adequacy of monetary reserves, and the fear has been expressed that there might be competitive efforts on the part of many countries to increase their reserves, which would give rise to what has been called “a scramble for reserves” or “a scramble
for international liquidity." I think that these fears are exaggerated out of all proportion to reality. It seems to me that after the redistribution of reserves which has occurred in the last few years, very much as a result of the deficit in the U.S. balance of payments, one industrial country after the other is beginning to think that its monetary reserves are sufficient from its balance of payments point of view. This change in attitude may prove to be very important, for it gives an increasing number of these countries the opportunity to shape their fiscal and credit policies without feeling a need to strengthen their reserve positions.

It is true that many developing countries have very low reserves, but what these countries need most is long-term capital to finance their development programs. Although many of them would no doubt be wise to pay some attention to building up their reserves to a safer level, whatever efforts may be made by them to do so will presumably not cause any appreciable difficulties from a general liquidity point of view.

But returning to the position of the industrial countries, there are certain basic developments which point to the restoration of a more enduring equilibrium between the economies of most of these countries. After the convulsion brought about by a world war, intensified in some cases by the changes in the postwar reconstruction period, it is not easy to establish a harmony between costs and prices, or a proper money supply, or the appropriate conditions in the long- and short-term capital markets in the domestic economies of individual countries; it is even more difficult to attain this kind of equilibrium between the economies of different countries. Such an equilibrium was never really attained after the First World War; and after the Second World War there have been several periods of intense monetary tension, indicating the continuance of an unbalanced position. There have been certain indications, however, that we are now approaching what may well become a state of equilibrium solid enough to withstand the impact of such pressures as will never be wholly excluded. Thus, as far as changes in costs are concerned, resulting from the interrelation of wage rates and productivity, there has recently been little if any cost increase in most sectors of the U.S. economy, while in several European countries wages have risen noticeably more than productivity, with a consequent pressure on costs. The difference has been sufficiently important to have an impact on the balances of payments. As the
realization of these facts spreads in ever-widening circles, confidence in currencies recently under pressure will be reinforced. Such a tendency is, I believe, being confirmed by the evolution of the foreign exchange markets, which, with the exception of brief disturbances, have this year been characterized by greater calm than over any similar period since the war.

Effects of Restored Confidence

Those who are in the habit of analyzing the significance of these various indicators are, I think, beginning to feel increasingly reassured that the present monetary structure can be effectively maintained on a foundation of stable exchange rates, thus providing a reliable basis for further economic development and for the shaping of official policies. I do not want to imply that continued efforts are unnecessary, but I think that they can be pursued in an atmosphere of greater confidence. And I also think that what has been achieved already may well come to exercise an influence on government policies and actions in a number of ways.

Firstly, since a much better balance has been attained in the international payments situation, it follows that the extent of the remaining maladjustments in the cost and price and interest rate relations, as reflected in capital movements between individual countries, has been greatly reduced. Therefore there is reason to believe that further corrective policies, insofar as they are still needed, will not have to be so extensive that their effects should prove too disturbing, nationally and internationally.

Secondly, I believe that the efforts already made, and those which may still be required, will prove successful in assuring a stable exchange rate structure without any alteration in the present price of gold. The now ample monetary reserves of so many individual countries, together with possibilities of resorting to reciprocal central bank credits and ready access to the increased facilities of the International Monetary Fund, provide formidable lines of defense against any pressures that might arise in the future.

Thirdly, with the improvement in the general situation, it should be possible to avoid policies which reflect a distrust in that
situation and which might detract from the efforts to solve real problems. For this and other reasons I can, for instance, see no merit in building a system of extensive gold guarantees.

Fourthly, in view of the improvement which has taken place, it seems that in many countries the monetary authorities could now regard fluctuations in the level of their monetary reserves with growing equanimity. The causes of whatever movements do occur in the reserves should, of course, continue to be analyzed and explained, but the fluctuations from week to week and month to month should no longer excite opinion to the same extent as they have done in recent years.

The policies I have mentioned so far are primarily concerned with the maintenance of exchange stability, but what about the question of ensuring a sufficient degree of liquidity? As I have already mentioned, the liquidity required to finance world trade (as well as domestic trade) is in terms of national currencies. Thus the expansion of international trade is financed through the credit mechanism in individual countries.

Scope for International Cooperation

But in matters of credit policy there are limits to the extent that countries can safely move alone; they have in a measure to keep in step with each other. Given present circumstances, in which there is a better basic balance in the world’s payments situation and more and more industrial countries feel that they have by and large a sufficiency of reserves, there are more than ever good reasons to intensify the useful cooperation which has been initiated among monetary authorities. This cooperation can be pursued in a number of ways, all of which should be welcomed. What may be needed may not always be policies aimed in the same direction. Situations may arise in which different countries have to pursue contrasting but complementary policies, involving a more cautious policy in one country or one group of countries and a more expansionary policy in others. The choice of the right combination of policies should be the subject of common discussion and coordination. But the object of all these efforts must be to provide in the individual countries, and thus for the world as a whole, the volume of credit creation required to meet the legitimate needs of growing economies.
I cannot help adding that as monetary confidence increases, and I have every reason to expect that it will, there should be less eagerness on the part of private individuals to hoard gold. One consequence of reduced hoarding would be that more and more of the current gold output, which has been increasing from year to year, would become available for monetary purposes, and this in turn would facilitate the pursuit of appropriate credit policies. Cooperation among monetary authorities does not, of course, mean that gold is discarded as a basis for currencies; it can still play a useful role in the pursuit of credit policies in the framework of a managed gold standard.

I want to stress that the endeavors to establish fiscal and credit policies answering the needs of growing economies will benefit not a limited group of countries but all countries. I have already pointed out that there is at the moment a sufficiency of liquidity, and in that connection I referred to the increase of \( 6 \frac{1}{2} \) per cent in the value of world trade in the first half of 1962 over the similar period in 1961. It is interesting to note that preliminary estimates indicate that the exports of the primary producing countries rose at about the same rate as those of the industrial countries; the imports of the primary producing countries as a group increased much less. There has thus been a welcome expansion of trade in primary products.

One of the most pressing problems confronting the developing countries, and not least the newly independent countries in Africa and elsewhere, is the need for them to pay particular attention, in the development of their economies, to the promotion of exports. Certainly these countries would all be greatly helped by a reduction of artificial barriers impeding the free flow of trade and payments with other countries, and by mutual arrangements designed to make the best possible use of the scarce resources at their disposal. For the newly independent nations there is a clear advantage in close economic and monetary cooperation among countries that historically have belonged to the same currency and trading area, and even among those that have belonged to different currency and trading areas. It is particularly important that these nations, whose economies have traditionally been joined in economic union with some of their neighbors, should not relinquish the very real advantages derived from the historical absence of barriers and from the existence of common currencies and institutions, which make it
possible to pursue a coordinated development effort for the benefit of all the participants. But while it is the responsibility of the developing countries to pursue policies which facilitate exports, it is, at the same time, the responsibility of the industrial countries to pursue liberal trade policies, opening their markets to imports from less developed areas. By such policies they would in a constructive way contribute to the welfare of the developing nations, old and new.

Moreover, I want to point out that the cooperation to which I have referred among the monetary authorities should, as one of its beneficial effects, ensure the avoidance of deflation at a time of greatly increased capacity in so many lines of production. The success of enlightened fiscal and credit policies in the industrial countries should indeed be very much to the advantage of the primary producing countries. There has been a growing awareness of the difficulties which a number of primary producing countries have experienced through the fluctuations in the prices of their main products, and the Fund has been connected in various ways with the examination of these problems. Assuming, as I think we may, that it will be possible to avoid any marked decline in the present general level of raw material prices, there may still arise acute difficulties for individual products, such as have occurred in the case of coffee now being intensively discussed, and these difficulties will create serious problems for the producing countries. For those products, special commodity arrangements may well be necessary. Such arrangements should, of course, be designed to facilitate rather than to discourage the diversification of exports.

But even if all this is done, it is to be expected that wider problems arising from their over-all balance of payments positions will affect a great many of the developing countries. Experience shows that the causes of such difficulties as can arise are of a great variety; it follows from this that there is great merit in analyzing each particular situation. When balances of payments are involved, naturally the Fund has a special responsibility, which will demand increasing attention, and I am sure that this will be given.

The Need for Longer-Term Resources

Over the years, the Fund has had increasingly intimate contact with the developing countries. While the Fund's financial assistance
is related to balance of payments problems, and is repayable, as I said before, within not more than three to five years, the requirements for the financing of development programs are of course of another character, long-term resources being needed, largely related to specific programs. But this does not mean that the Fund is not interested in the whole complex of these problems; to mention only one aspect, both internal and external financing of development have obvious monetary repercussions. Concentration on non-inflationary sources of financing is more and more found to be the key to sound development; and fiscal and credit policies are therefore essential elements in development planning. As the Annual Report points out, experience has shown time and again that an attempt to promote development by inflationary financing almost inevitably brings in its wake a flight of domestic savings and diversion of investment into nonessential lines, a reduction in capital inflow, a decline in export earnings, and distortions in the economy, all of which lead to a discouragement rather than an encouragement of the healthy economic growth which is a basic objective of the Fund's work.  

One of the new forms for providing financial assistance to developing countries has been the formation of consortia under the leadership of the International Bank for Reconstruction and Development, and also of the Organization for Economic Cooperation and Development. Fund officials have taken part as observers in meetings of these consortia. It seems natural that in the future the Fund, pursuant to its purposes, will become more closely associated with these endeavors, and generally with development efforts. In the whole of this area we are faced with many new problems, which will present many difficulties. But thorough examination of each situation in an international setting would seem to provide the greatest assurance that economic considerations will prevail; and thus waste will be avoided. In that way, the great efforts now in train to ensure a steady expansion in individual countries, and therefore also in the world economy, would attain their maximum effectiveness.

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In this review, I have touched on many difficult problems in the fields of action with which the Board of Governors meeting here

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today is concerned—mentioning some of the achievements and also some of the problems with which we are still faced. Whatever the difficulties that are already present or that may loom on the horizon, there is in my opinion no need to be pessimistic. Let us not overlook the very constructive developments that have taken place since we met in Vienna a year ago. The borrowing arrangements providing the Fund with supplementary resources will very shortly enter into effect, and cooperation in other ways among monetary authorities has been strengthened. Trade has continued to be liberalized, and world trade continues to increase. New consortia for financing development programs have been formed, and the flow of assistance is, I think, increasing. The possibilities of further action are certainly not exhausted. We can take heart at the progress that has been made, and again at this Meeting give a demonstration of a firm resolve to mobilize and manage economic and financial resources internationally for the improvement of the conditions in our individual member countries, and therefore for mankind in general.
Liquidity and Foreign Trade *

I do not think that there is any need for me in this gathering to emphasize the importance of trade, either domestic or foreign. A number of books have been written about the Roman Empire which ascribe its decline largely to economic reasons; one in particular, I remember, pointed out rather curiously that as the Roman Empire grew and grew its foreign trade became less and less until the Empire eventually comprised almost the whole known world, and then it had no foreign trade at all and its economy collapsed. Now this, of course, is economics made altogether too simple, and besides it is not altogether true, for there was always some trade with the East. But there were nonetheless important economic factors contributing to the decline. After the Second Century, excessively bureaucratic control, heavy taxation, and an overdose of regulations all contributed materially to a falling off of trade within the Empire. Even if this cannot be said to have been the sole cause of the ultimate collapse of the Empire, it was certainly a symptom of its gradual decline. Flourishing internal and external trade is usually indicative of an active and vigorous society.

Trading communities have contributed much to present Western culture. Athens, the font and origin of that culture, was a trading city. Other cities in later periods, famous for their art and learning and fresh flowering of our Western culture, were the Renaissance towns of Florence and Venice, and later Amsterdam, Paris, London, the free cities in Germany and Switzerland—Frankfurt, Basle, and Geneva—and also Boston, Philadelphia, and New York here in this country. All of these derived much of their wealth and importance from trade, as well as being at the same time political centers of considerable importance. I would even venture to say that our civilization has more than anything else developed through the activities, and often the peoples, of our great trading cities. The relations which are established by trade bring in their

* Speech before the 49th National Foreign Trade Convention, New York, October 29, 1962.
train more sweeping considerations than mere gain or profit. Trade widens horizons; it makes people aware of customs and ideas elsewhere; it both sharpens and broadens the mind, and almost inevitably promotes tolerance. In our day, too, I think we can find that freeing of trading relations has had a liberating effect on people's minds.

We have been fortunate that after World War II the volume of trade has increased almost without interruption—in sharp contrast to what has generally happened after previous great wars. From 1950 to 1960 the volume of international trade rose by 78 per cent; in 1961 by 4 per cent; and it seems that from the first half of 1961 to the first half of 1962 the increase has been at the rate of some 6 per cent. This is a remarkable performance and a very real achievement, but it has not come about by itself; a number of factors are required to create a climate conducive to an increase in trade. There has to be greater production, for products are exchanged for products; there have to be the resources available to finance the trade; and in a postwar period the wartime barriers to trade have to be dismantled or at least reduced. Over the years many efforts have been made to achieve these conditions, with a considerable degree of success. In part this success has been due to the work of international agencies: the Marshall Plan with the European Payments Union, and such organizations as the GATT, the World Bank, and the International Monetary Fund. Much has also been achieved through the efforts of individual countries to restore proper trading conditions. Efforts to expand world trade further have, if anything, recently been intensified. The European Common Market has in important respects advanced its timetable for the reduction of tariffs; Great Britain is applying for full membership in the Common Market; and here in the United States, Congress has adopted, and the President has signed, the Trade Expansion Act of 1962.

International Cooperation

These are all evidence of a high degree of cohesion in policies in the general economic and commercial field among the different countries—a greater cohesion perhaps than there has ever been, and certainly more so than at any time since the outbreak of World War I in 1914. The European Common Market, its extension to
countries in Europe other than the Six, and the Trade Expansion Act are, taken together, measures which should give a new orientation to trading relations in the Western world, and make it possible for the benefits of reduced tariffs to be enjoyed not only by the industrial countries but also by the wider group of developing countries.

In the financial and monetary field, too, common measures have been agreed upon. Last week the borrowing arrangements of the International Monetary Fund came into force, according to which ten of the leading industrial countries undertake to provide the International Monetary Fund, in case of need, with supplementary resources. . . . Most of the industrial countries have by now substantial reserves of their own; and further protection can be provided by a system of reciprocal credits between central banks. So, formidable defenses have been built up against any setback to individual currencies or the international monetary system as a whole, and I think we can by now feel sure that speculators can no longer determine monetary policy by their movement of funds.

It involves no disparagement of the political leaders to say that it has been difficult to arrive at agreed lines of action in the political field, for in that field so much is influenced by countries’ relations with the communist world. Arrangements in the economic and financial field, on the other hand, have been made primarily among countries whose economies are all more or less based on the market system, and this has greatly facilitated the attainment of positive results. I think that in such matters one can now to a large extent take goodwill for granted; and the will and the willingness to cooperate which such an atmosphere generates. Now these remarks embrace, of course, the whole complex of problems relating to world trade, which is indeed a very vast subject. But I will confine my remarks today mainly to one particular aspect, namely, the relation between liquidity and world trade, and I am afraid that, in the time allotted to me, I can really deal only—or almost only—with the problems of the industrial countries, which, after all, by their policies, more or less determine the trend of world business. Neither shall I touch on methods of export financing and such matters—important though they are—but shall devote myself to more general problems.
Significance of Liquidity

May I first say a few words about the concept of liquidity. Unfortunately, economic terms are rarely unambiguous, and the term “liquidity” is no exception. There are, in fact, two distinct meanings given to this term—and I am afraid that very often it is not clearly indicated which meaning is being used in a particular context, and this makes it difficult to be sure exactly what the idea is that the writer is intending to convey.

One concept of liquidity may be taken to be the availability of the facilities in national currencies for financing trade and other business. As you know, Keynes in his General Theory was very much concerned with the state of liquidity in its relation to economic activity, and he thought of it in terms of the credit facilities in national currencies. On reading recently through some Congressional reports on the credit position here in the United States, I again found that the use of the term “liquidity” most often referred to the availability of funds in dollars here in the national economy.

There is another kind of liquidity—often referred to as “international liquidity”—which is concerned with the reserve position of countries, i.e., with the magnitude of their gold and foreign exchange reserves, as supplemented by other facilities, such as drawing rights in the International Monetary Fund and the various forms of reciprocal and other credits agreed between central banks.

These two concepts of liquidity must be clearly distinguished, for otherwise confusion is bound to arise. The need for such distinction is not least needed because there is an interrelation between them—between, on the one hand, liquidity in national currencies and, on the other, international liquidity in terms of monetary reserves.

As trade increases—either domestic or foreign trade—enlarged credit facilities are required in national currencies to ensure adequate financing. Trade is of course financed in national currencies, and foreign trade is financed largely in the currencies of the main industrial countries. Thus an expansion in foreign trade is financed through the credit mechanism in individual countries. Under the old gold standard, the creation of credit in the various countries was closely linked to movements of gold, and in quite a number of countries, changes in the volume of credit have continued to depend to a large extent on changes in their balance of payments,
as reflected in their monetary reserves. But despite this link, one should guard against implying that no increase in the credit volume can occur without an addition to monetary reserves. Here in the United States, for instance, credit has been expanding over the last ten years, despite the considerable decline in the gold stock. In the Federal Republic of Germany, too, credit has expanded over the last two years without an increase in reserves. And if I may refer to a classical example, the Bank of England, before 1914, was virtually the center of the world's credit system and was able to hold this position on the basis of surprisingly slender reserves, which never amounted to more than the equivalent of $400 million at present-day values. So the link is not absolute; there can be no question of any inherent parallelism between the expansion of credit and growth of reserves.

Flexible Credit

If we examine the credit systems of the various countries, we find that in many of them modern techniques, not least through the initiation of open-market operations, have given greater flexibility to credit management than was possible previously. I mentioned open-market operations; it is, I think, not always realized how modern in its present form this technique is. The Open Market Committee of the Federal Reserve System was established in 1936, but it was only after the famous accord between the Treasury and the Federal Reserve in March 1951 that the Committee could begin to pursue flexible policies, and it has since become what can now be regarded as the effective central banking institution directing the monetary affairs of the United States. The monetary authorities can avail themselves of these possibilities, and can do so more decisively, if they have a relatively strong foreign exchange position. Fortunately, partly through the deficits in the U.S. balance of payments, a redistribution of reserves has occurred in recent years, so that most of the principal industrial countries have what they may regard as a sufficiency of reserves, and they have also the other facilities available to them which I have mentioned, among them access to the International Monetary Fund. These are valuable, not only as lines of defense, but also as permitting the authorities a freedom of action not otherwise sustainable.
Even so, in matters of credit policy there are limits to the extent that countries can safely move alone. They have in a measure to keep in step with each other. Given present circumstances—in which there is a better basic balance in the world position, at least among the industrial countries, and, indeed, greater possibilities for concerted action—there are more than ever good reasons to intensify the useful cooperation which has been initiated among the monetary authorities. This cooperation can be pursued in a number of ways: through the International Monetary Fund, through the OECD in Paris, through the Bank for International Settlements in Basle, and among the Common Market countries; all of these should be welcomed. The policies which may be needed, and which are therefore appropriate to be discussed in such places, may not always be policies aimed in the same immediate direction. Situations may arise in which different countries have to pursue contrasting, though complementary, policies, involving a more cautious policy in one country or one group of countries, and a more expansionary policy in others. The choice of the right combination of policies should be the subject of common discussion and coordination. But the objective of all these efforts must be to provide to the individual countries, and thus to the world as a whole, the volume of credit creation required to meet the legitimate needs of growing economies.

It is sometimes questioned whether there are at present sufficient credit facilities to meet the needs of growing economies, and, in particular, the needs of an increasing world trade. As I have already mentioned, the volume of foreign trade rose from 1960 to 1961 by some 4 per cent, and it seems that from the first half of 1961 to the first half of 1962 the increase has been at the rate of 6 per cent. Such increases would surely not have occurred had adequate financing not been forthcoming. Indeed, I think most of those competent in these matters would agree that foreign trade is not likely to be stifled by any lack of credit facilities, especially as interest rates seem to be declining rather than rising in the leading centers.

Prices and Costs

It would be good if this were all that need be said about this question; but I am afraid it is not. There is, I think, another facet
of the problem with which we have to be concerned. It is not only that in some countries—particularly here in the United States, and to some extent in Great Britain—there are unused facilities of production and an undesirable level of unemployment. We have really to ask ourselves whether there is not now a more general slackening in the rate of economic expansion—a slackening which may also be beginning to affect countries on the continent of Europe and which, if it continues, could lead to another recession and perhaps even set off deflationary tendencies, which then would have to be counteracted by, among other things, an expansion of credit. For three years, wholesale prices both here in the United States and on the world markets have been remarkably stable, evidencing the end of the postwar inflation. Supply has caught up with demand; and as productive capacity continues to increase, a downward pressure on prices may well be intensified in a wide range of products—raw materials, semimanufactures, as well as finished manufactured products.

There is, however, another point, even more appropriate to present conditions. Deflation can undoubtedly be brought about by mistaken monetary policies, but in the present situation it is well to remember that it can also result from the effects of continuous cost increases. In the postwar period, when prices could be raised without any significant reduction in sales or even with an upturn in sales, cost increases were not really a source of worry but became rather an accepted part of the inflationary process. But when prices can no longer be increased because of intense competition, cost increases may have a very different effect. They will tend to reduce profit margins—and the lower profit margins may slow up the rate of investment, with the result that savings may not be fully invested, idle funds may accumulate, and a deflationary process may be set off. So, if profit margins are reduced by cost increases, these increases may give rise not to inflation but to deflation.

There is nothing new in this analysis. If you read W. C. Mitchell's famous book on business cycles, published some thirty years ago, you will find that he described the phase of the business cycle which leads to the downturn as one in which costs continue to rise while prices can no longer be increased, so that profit margins are reduced, and even losses incurred, with all the accompanying results of such a trend.
It is also useful to remember that Keynes defined liquidity in terms of wage units. It is true that he argued against a reduction of wages, even in a period of unemployment, for he feared that such a step would give rise to expectations of continuous further decreases, both of wages and prices. But he was explicit in his argument against any increases in wages when there was widespread unemployment, since, if the cost of labor were to rise, the increase in liquidity which he recommended would lead to less absorption of the unemployed.

There is sufficient agreement between the views of these two great economists for us to conclude that in situations in which the objective is to counter a relaxation in business activity and to promote recovery, cost increases should be avoided to the utmost. We may well have such a situation in the very near future, if it is not already here with us, and therefore these precepts of moderation in cost increases should be taken very seriously.

**U.S. Economic Prospects**

Turning to the present position in the United States, I think it would be a great mistake to underrate the recovery in business activity which has taken place over the last eighteen months. After all, the gross national product has risen in that period by some 7 to 8 per cent; and, furthermore, this increase, it should be noted, has been accompanied by an improvement in the balance of payments. That is in itself an achievement, for it is not often that internal recovery and an improvement in the balance of payments go together. At the Annual Meeting of the Fund and the Bank, which took place in September, European bankers expressed increased confidence in the dollar and looked forward to the restoration of equilibrium in the U.S. balance of payments in the course of next year. There are several reasons for the improvement that has taken place in the position of the dollar, but there is no doubt that the most fundamental is that, in the last few years, wage costs have risen at a much quicker rate in the countries on the continent of Europe than here in the United States. German wages, for instance, have risen internationally by some 30 per cent in three years, if we take account of the revaluation of the deutsche mark, while the increase here has been on an average less than 10 per cent in the same period. I might add that this strengthening of the
position of the dollar has been reflected in the quotations on the exchange markets, and these markets have behaved, and continue to behave, very well.

Looking at the economic situation this autumn, I certainly see no sign of an immediate dip in business here in this country. Sales and output of automobiles are well-nigh at record figures, and many branches of industry and trade are doing really well. But the picture is not uniform; somehow one has the impression of business activity moving along on a plateau, with no clear indication of any fresh stimulus exerting its beneficial effects. This is not a satisfactory situation, and it is, therefore, up to us to see to it that conditions for a restimulation of business should be provided, to the largest possible extent. It seems widely agreed that present high rates of direct taxation act as a drag on business, and that steps should be taken to reduce those rates. Such steps could form part of a broader expansionist policy in the fiscal and credit field—a policy for which there is, I think, much support in this country at present. I might add that in important aspects, both in the budget field and in the pursuit of easy money, expansionist fiscal and credit policies have already been inaugurated in this country; and, therefore, the question is rather in what way, and to what extent, the present policies should be intensified in the coming year.

If we now look at the other side of the Atlantic, I think we can take it for granted that the British authorities are also anxious to pursue expansionist policies—and will move in that direction as far as they feel they can safely do so.

How will these policies in the United States and Great Britain relate to conditions in the countries on the continent of Europe? If the boom in these countries continues more or less unabated, the expansionary policies in the United States and Great Britain would complement the continued expansion on the continent of Europe. There have, however, been some signs of a decline in the rate of expansion in Europe. Should this tendency be intensified, it is very likely that the European countries would fairly promptly consider steps to avoid a serious downturn, and do so in cooperation with the authorities in the United States and Great Britain. There were indications in the course of last summer that an increasing number of Europeans were interested in the launching of more expansionist policies in the United States, insofar as that could be
done without retarding the improvement in the U.S. balance of payments. Since the U.S. dollar's position has gone on improving, while the business situation inside Europe has become rather more uncertain, the European interest in U.S. expansionary policies is likely to be now even stronger.

A Program for Cooperation

Whatever situation may develop on the continent of Europe, therefore, there is every reason for continuing close cooperation among the authorities on the two sides of the Atlantic, in order to arrive at a full understanding as to the policies that should be pursued. At the very least, such understanding can be useful in eliminating distrust, but it can, of course, do much more.

I think I might sum up by saying that there are three important points on which I would hope there would be broad agreement:

1. The pursuit of expansionist policies, to a greater or lesser degree, according to the business trend that emerges;
2. The avoidance of cost increases, which presupposes moderation in wage increases; and
3. Intensified cooperation in the monetary, economic, fiscal, and trade fields among the authorities of the various interested countries.

It may be easier to arrive at results under the first and the third than under the second heading—easier to pursue expansionist policies and to intensify international cooperation than to secure avoidance of cost increases—but it is by the proper combination of action under each one of these three headings that success is most likely to be attained. I would like to point out that the avoidance of cost increases is just as important for internal reasons to ensure the absorption of the unemployed by continued economic expansion, as for external reasons to ensure an equilibrium in the balance of payments.

I would like to make it clear that while the policies which have been outlined above are those to be discussed among and adopted by the industrial countries, they would nevertheless be greatly to the benefit of the developing countries also. For the pursuit of these policies is likely to increase especially the demand for primary products and, at the same time, to counteract any tendency for the prices of these products to decline further.
In recent months I have mentioned more than once the word "deflation." It is not because I want deflation, or even expect it to come about; just the contrary. Let me mention what a very wise Swedish banker, the late Marcus Wallenberg, once said to me. He said that it was often his role in life to be considered to have been wrong in his judgment. When he saw the signs of some dangerous situation developing, he would go around warning people of the danger, and indicating the measures which, in his opinion, should be taken to avert it. If then the proper measures were taken and the danger was averted, he would be told that he had been wrong; but nobody could be more pleased than he when such a thing happened.

Finally, I would like to point out the fact that business this year has shown great resilience in the face of often adverse circumstances. Usually a sharp fall on the stock exchange has been the forerunner of a distinct setback in business activity, but this year business on the two sides of the Atlantic seems to have taken the fall on the stock exchange well in its stride. Business has also gone steadily on its way, unperturbed by politics, relating its action to economic realities on which it may exercise its judgment with some confidence.

It is particularly interesting to observe the movements on the foreign exchange markets, for these are usually the most sensitive to rumors of all kinds. For the greater part of this year, these markets have been very calm, probably calmer than at any time since before the outbreak of World War II. Such variations as have occurred in the exchange rates seem to have been increasingly determined by the basic conditions of the balance of payments in individual countries (e.g., the relation of exports to imports, and the like) and less by movements of capital funds from one center to another. One reason for this is, of course, that the international balance of payments position is now in better equilibrium than it has been for several years. But another reason is surely to be found in the fact that the monetary authorities in the various countries now cooperate more closely together, and that the defenses against sudden pressures have been greatly strengthened.

At the same time, with a more soundly based economy, many countries have gained more freedom in the pursuit of their fiscal and credit policies. The important thing is that they use this free-
dom wisely. But to be wise, of course, does not mean to do noth­
ing; real wisdom requires readiness for action when the need for
such action occurs. Moreover, it requires that attention should
be paid to all aspects of a problem, and should include a readiness
to adopt those policies which are often difficult to apply. I think
that in general there is a greater understanding of the problems
involved and awareness of the greater opportunities which now
present themselves. The fault is not in the stars but in ourselves if
we should fail—but why should we fail? Why should we not be
resolute in pursuing those policies which would ensure a steady
rate of growth in our economies and an expansion in world trade?
Much good work has been done. Much work remains to be done.
But let us agree to do it!
The Role of Money in a Dynamic Economy *

Axel Oxenstierna, the eminent Chancellor of Sweden who was such an important figure in the Thirty Years War, is perhaps best remembered today for what he wrote in a letter to his son: “Do you not know, my son, with how little wisdom the world is governed?” He was a very wise man, which was shown among other things by his willingness to recognize that there were things he did not know. Toward the end of his life (he died in 1654) he once said that from the time he was a young man he had been trying to understand about money, but now that he was old he had to admit that he felt he knew as little as when he had first thought about it. At the time Oxenstierna lived there was a great deal of discussion about the rise in commodity prices in connection with the influx of gold and silver via Spain from the New World, and some useful observations on this and on money matters generally were expressed by the Frenchman Bodin and later on by the Italian Davanzati. But it was really only toward the end of the seventeenth century that some sort of coherent analysis was worked out, including the basic notions of the quantity theory and the velocity of circulation, the main contributions being made by the English economist, Sir William Petty, and the philosopher, John Locke. It was also at that time (in fact, in 1694) that the Bank of England was founded, but it took another century for the importance of credit to be recognized by the monetary theorists.

Much progress in the understanding of monetary matters was achieved during and after the Napoleonic Wars, when the money movements that occurred aroused considerable curiosity, and many penetrating analyses and explanations were made by David Ricardo and others. In the second half of the nineteenth century, in the heyday of the gold standard, it was gradually learned by experience how to act and react in different situations where gold was being received or flowing out, where business was active or slack, or

where a critical situation was building up or subsiding. What was thus established began to be called the “rules of the game” under the gold standard, and one of the great advantages of this system was that the rules, although without any legal obligation, were almost universally observed, and the world was thus able to benefit from the existence of an international monetary system. However, it is perhaps worth remembering that, at that time, provided Great Britain played according to those rules, and provided a very few other more advanced countries more or less did so, the monetary behavior of the rest of the world did not matter very much. The system was, of course, not perfect, but it cannot be denied that it worked remarkably well . . . Also, people had a feeling that they understood how the system worked. I had my first examination in economics in May 1914, and I remember how one of the Swedish professors of economics at that time expressed the opinion that of all branches of economics the one most fully explored was that of monetary affairs.

I have begun with the briefest of thumbnail sketches of 250 years of monetary history. I would like to continue by relating in somewhat greater detail, albeit still briefly, the economic developments of the past 50 years. I want to do this because I believe there are important lessons to be learned from the experience of those years. I want to look at the past also because I believe that the role of money is not something which can be regarded in isolation; it has to be related to many other factors— to the general trend of business, the movement of costs and prices and the main characteristics of economic life at any given time. It is only by so relating it that we can arrive at some idea of the policies which should be pursued by those in whose hands the management of money rests. I am thus trying to elucidate the role of money in a dynamic economy by reference to the concrete situations in which countries have found themselves in the past and at present.

There are those who would prefer to deal with this question in terms of mathematical formulas—and may I add that I have no objection to such an approach. After all, the two economists whose writings most influenced me in my youth were Alfred Marshall and Knut Wicksell, both eminent mathematicians. But there is a danger in relying one-sidedly on formulas, since they have always to be
based on certain assumptions, and it is not at all certain that the assumptions chosen correspond to the conditions of the real world in which we live. In this world the actions and reactions of all and sundry, including the behavior of politicians, have to be taken into account. There is a great deal to be said for the notion that economics is a branch of history; from such a premise we have then to try to seek to distill out of our historical experiences what have been essential sequences of cause and effect to be used as guidance for the future. Naturally, if the reasoning is right, the historical and the mathematical approaches should lead to the same result: a proven principle regarding the interrelation of economic factors, which is the goal at which economics must aim.

Restoration of the Gold Standard

Fifty years ago, Europe was preparing for World War I. This war, apart from everything else, had important monetary effects. While it lasted, and even after it had finished, there was an inflationary rise in prices, varying from country to country, but affecting neutrals as well as the belligerent nations. The student of monetary affairs soon found himself faced with problems of exchange relations and other matters that were new to him. When the war was over and the question arose in what way monetary order should be restored, the general body of opinion in all the leading financial centers was overwhelmingly in favor of a return to the gold standard, and for the majority of countries restoration of the old gold parity was the only action seriously considered. I know myself how strong this view was, for in 1921 I wrote an article pointing out that for Sweden a return to the old gold parity would necessitate a sharp fall both in prices and wages, in order to bring them into line with world market conditions; it seemed clear that this could not be done without intense labor disputes, bankruptcies of many firms, and severe losses in many others. I therefore proposed the linking of the Swedish currency to gold at a new parity. This article gave rise to a long discussion, but there was only one person of note, Dr. Gustav Dalén, a scientist, inventor, and Nobel Prize winner, who wrote an article supporting the view I had expressed. For the public in general, who perhaps did not

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understand all that was involved, a return to the gold standard at the old parity seemed to constitute a safeguard against the inflation which had been suffered during the war, and held out the hope of the upward business trend being restarted. On the basis of prewar experience, the gold standard in no way appeared to endanger the dynamism of the economy. Had not the years before 1914 been years of progress, and had not the gold standard provided a basis for this dynamism? In the discussion of these questions there was no set difference of opinion between conservatives and others. Indeed, in spite of the decline in wages that resulted from the maintenance of the old parity, the Swedish Socialist Party did not at all oppose the return to the gold standard at the old parity.

Some years later I had the occasion to discuss the question of "a managed currency" with the leader of the Socialist Party in Sweden, Per Albin Hansson, the then Prime Minister; he told me that he had never been enamored of the idea of a managed currency as compared with the more automatic system of the gold standard. He said he had asked himself who it would be that would do the management. He felt sure that it would not be the workers, but people closer to his political opponents, and he feared that they might manage the currency in such a way that real wages would be reduced. The link to gold meant that when the trade unions reached an agreement with the employers, the workers could not arbitrarily be deprived of the benefits.

The 1920's was a period of considerable economic expansion; by 1929 the volume of world trade, for instance, was 30 per cent higher than it had been in 1914. For my own part I began to think that I might have overrated the difficulties that the return to the old gold parity might entail; perhaps it had given countries the appropriate basis for a renewed period of growth. It is true that there were some symptoms of trouble ahead, particularly in the field of raw material prices, which had begun to decline in 1926. But the significance of this development was dwarfed by the collapse of security prices on the New York Stock Exchange in 1929, and the setback in business activity thereafter. It is interesting to note in retrospect that in 1930, and even in the first half

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a Ibid., page 45.
of 1931, there was little or no feeling that the industrial countries were facing a serious depression. There was still the feeling that the old methods of overcoming a cyclical business decline would work. Wages were reduced by up to 10 per cent in some European countries and up to 20 per cent in the United States, and it was thought that in this way sufficient profit margins would be re-established and business would again move upward, it being believed that “recovery was just around the corner.” It was when these expectations were not fulfilled, when in spite of all the cost reductions and other measures business continued to get worse, that hope was deferred and serious doubts began to be expressed about the efficacy of the old methods.

It needed, however, some dramatic events to bring home to people in general how profound the crisis was that had suddenly enveloped the Western world. Apart from the persistent heavy unemployment, not only sustained but continually increasing in some countries, one such event was the devaluation of sterling (and some other currencies) in the autumn of 1931; another was the banking crisis in the United States and the devaluation of the dollar in 1933. Still the gold bloc countries—France, Italy, Belgium, the Netherlands and Switzerland—held out, following for several more years their version of orthodox policies, but when their currencies had to be devalued in 1935 and 1936, the submission to the forces of change was complete. The mark of these events and the long drawn out depression of the 1930’s, with stagnant world trade and massive unemployment, burned itself ineradicably into the minds of the generation who lived through those times; it was felt that the inherited economic system no longer worked and would have to be replaced by something new. Thus it was the Great Depression, much more than either of the two great wars, that stands out as a watershed between two main currents of economic thought. Though there were those who refused to be swayed by the new notions, there can be little doubt as to the emergence of new influences in economic thinking, which had their origin in the Great Depression.

It may help to understand the problems which presented themselves if I try to explain why it was that in the early 1930’s able people, including able labor leaders, so firmly believed that a reduction in wages would, with little delay, restore profits and lead to a recovery in business.
In the 20 years preceding the outbreak of war in 1914, the world’s annual gold production (after the discovery of the Transvaal Gold Fields in the late 1880’s) increased sufficiently year by year to ensure a high degree of credit expansion, and thus also an increase in demand which, notwithstanding the growth of output, even led to a rise in prices. When during those years there was a depression (or what we might call today a recession) it was sufficient for costs to be reduced to spark off a recovery, for the increase in demand could be taken for granted, thanks largely to the rise in gold output. In such circumstances it was possible for businessmen and economists to concentrate on cost adjustment as the one thing needed to restore profitability and overcome the setback to business.

Problems of the Nineteen-Thirties

Why then did the same remedy of cost reduction prove ineffective in the years 1930-31? I think the main reason was that this time there was no increase in demand engendered, as it were, by the system itself. Let me explain what I mean by this. There was certainly no help from current gold production. The level of costs and prices was by 1929 some 50 per cent above the 1913-14 level, while the current gold output was less than before 1914. What there was of it was being absorbed by only one or two countries or by hoarding, and was thus not available to sustain the general level of world prices. Furthermore, there was at that time no other way in which an increase in monetary demand was being pumped into the economy. Once the boom was over in the autumn of 1929, the demand for commercial credit not only slowed down, but credits already granted were repaid. There was thus no increase in demand through the working of the private credit system; central banks did not undertake any significant open market operations to expand credit either on their own initiative or in connection with debt management of the government; and there was no general decline in interest rates to lower and more appropriate levels. In these circumstances the downward adjustment of wage costs was bound to fail, far-reaching though it was, for the other factor required to achieve recovery—the expansion of demand—was lacking.

There were, early in the 1930’s, some economists who began to realize the dangers of deflation; the most famous among them were
Gustav Cassel in Sweden and John Maynard Keynes in England. They were rightly insisting that continued cost and price reductions would bring no solution without determined measures to increase the volume of demand.

There were certain differences between the Swedish attitude as established in the early 1930's, and what Keynes put forward in the *General Theory*, published in 1936. According to the Swedish views, profitability could best be restored by a combination of cost adjustment and demand expansion; demand was expanded through devaluation of the currency, a program of public works and appropriate central bank policies. The decline in wages, which came, on an average, to about 10 per cent in the period from 1930 to 1932 was thus regarded as a useful element of the recovery policy, and it was considered that wages should be increased again only when there had been a substantial reduction in unemployment. In Australia, too, a reduction of wages was combined with an expansion of demand, and very much with the same motivation. The policies thus adopted proved singularly successful, and these two countries may be said to have escaped the really grim features of the Great Depression. In the case of Australia, a primary producer, with scarcely any industrialization at the time, this was the more remarkable in view of the sharp decline in the terms of trade which it then suffered.

Keynes grappled with similar problems. He, too, wanted an increase in demand and discussed various ways of achieving it. As far as costs were concerned, Keynes feared that a continuous reduction in money wages would set off cumulative deflationary forces, so he did not recommend a further reduction in wages. But, at the same time, he made it clear that the number of unemployed would not be significantly reduced if there were an increase in money wages. In other words, an expansion of credit would permit employment of more workers if the price of labor remained constant, i.e., if money wages were not allowed to rise. This is an essential feature of Keynes' theory, and recognized as such by one of the main proponents of Keynesian ideas here in the United States, Dr. Alvin H. Hansen, who has dealt with this question in his book *A Guide to Keynes* and in various articles.

So, whatever divergencies there may have been between the policies pursued in Sweden and Australia and the views of Keynes,
there was full agreement between them on the importance of preventing an increase in money wages as long as unemployment had still substantially to be reduced.

If one compares developments in Sweden and Australia with those here in the United States, it seems significant that in this country, both in 1933-34 and again in 1936-37, money wages were allowed to increase greatly. These wage increases undoubtedly made it more difficult to restore a sufficient degree of profitability, and must be regarded as one of the main causes for the failure to expand business and reduce unemployment in the 1930's here in the United States.

It may well be asked why after an interval of so many years I have been referring at such length to these past events. The reason is that I think the long drawn-out postwar expansion which has gone on since 1946 is over and that for the past few years here in this country, and more recently on the continent of Europe, a new situation has arisen which shows certain similarities with what happened in the early 1930's. I do not intend to convey the idea that we must repeat the sad experiences of those years, but I do think that we will have to take definitive measures to see to it that they are not repeated. 

*Postwar Expansion*

But before discussing the problems of this new situation, I should like to examine for a few moments the expansionary period following World War II. The experience of this period is in a way unique, for in the past after a large war the rule has been for there to be a very real depression. This was the case for many years after the Napoleonic Wars and for some years after the War Between the States here in this country; and again there was a very sharp but brief setback after World War I. There were many who believed that a similar experience would be repeated after World War II; but it was not to be so. The reason for the better fortune this time is not difficult to find. In 1945 there were large amounts of unspent balances in the hands of business firms and consumers, which had accumulated during the war. Wages, on the other hand, and prices generally, had been prevented from rising to great heights by the imposition of effective controls. Given the needs that had been unsatisfied during the war, commodities and services which could
be produced relatively cheaply were able to find ready customers at current prices with the result that business was active, with investment increasing, and there was consequently no depression. During and after earlier large wars, on the contrary, prices and wages had been allowed to rise to unprecedented heights in response to inflated demand and scarcity of goods and services. When the war was over, costs and prices proved too high in relation to peacetime demand; as a result, a period of adjustment had to be lived through before a new equilibrium could be reached. The key to the more fortunate development after World War II thus lies in the fact that much was done to hold back the rise in costs and prices by direct controls while the war was still raging, a task made easier than during earlier wars by the more industrialized nature of the economies and also because there were the lessons of World War I as an example. This analysis fits well with the developments in quite a number of countries, but particularly with those in the United States and Great Britain, and this is important since the trend in these two countries exerted a predominant influence on the general state of demand in the world markets.

In the situation following the war, where there was great demand for goods and services produced at competitive prices, full employment was ensured without any particular measures being needed to promote it—neither deficit spending nor easy money. The danger was rather that the stimulus would be too intense and the main task of monetary policy was therefore to restrain inflationary pressures. Here in fact was another period like that before 1914 in which there was no need to worry about any insufficiency of demand, but only about how best to avoid “overheating.” In the early postwar years many found it difficult to accept that the policy being followed was opposite to what had been appropriate in the Depression.

I do not want to convey the impression that in many respects the favorable conditions after World War II were produced without much effort; there were, in fact, a number of most important steps taken affecting these conditions, such as the Marshall Plan, liberalization of trade and the moves toward greater cohesion economically, first in the Organization for European Economic Cooperation and later in the Common Market. But the liquidity-cost factor was of essential importance.
This was a situation that could not last forever; indeed, it would have been dangerous if it had done so because it had the inherent weakness of being, on the whole, inflationary in its effect; it would before long have led to distortions of many kinds and to a serious loss of confidence, of which there were already beginning to be certain signs.

But this period is now in the main over. No industrial country can count any longer on the high profit margins resulting from really low costs in relation to prices. Excess liquidity has been worked off, supplies have caught up with demand, competition has become fiercer, both nationally and internationally. Here in the United States, wholesale prices have been practically stable since 1959, while the cost of living has not risen very much.

All this shows that there is not one remedy for economic ills, but that changing policies are called for in a changing world. I might mention that I have been upbraided for being inconsistent because I have favored sometimes easy money, sometimes restraint of credit. But when the basic conditions change there has to be a basic change in monetary and fiscal policies.

To understand the requirements of the new situation it is, I think, helpful to consider particularly the effects of a rise in wages. As long as the inflationary trend was still prevalent, individual firms would more often than not be willing to permit an increase in wages without offering any great resistance, since they felt they would be able, as a rule, to raise prices without suffering a decline in sales. Once, however, the inflationary trend was over, intense competition militated against the possibility of raising prices, and any increase in costs then merely tended to reduce profit margins. While income from wages and other sources of income have risen considerably, profits have not risen correspondingly over the last, say, ten or twelve years. In many cases, profit margins have become narrower here in the United States and also in Great Britain; and narrowing of the margins is now becoming a characteristic of some branches of industry on the continent of Europe. It is taking some time for businessmen and others to make the appropriate adjustments in their practices to the fact that inflation is over. As far as the stock exchanges were concerned, it was only in the spring of 1962 that the readjustment occurred which left market quotations at more realistic levels. The fall was in fact more marked in Europe than
in this country; in the Federal Republic of Germany and in Switzerland, the maximum fall from the peak came on an average to 40 per cent, compared with a maximum average fall of 23 per cent in New York. Although prices have now recovered somewhat, more noticeably in this country than in some continental European countries, these were important adjustments, and in their way indicated the advent of the new situation.

There is an important new element in the present situation to which I need also to refer, namely, the relation of the U.S. economy to other economies as reflected in the balance of payments position. It is true that already in the period 1949 to 1956 the United States had an over-all deficit in its balance of payments amounting to an average of $1.5 billion a year, but it was felt by most of those who followed these matters that such a deficit, largely a reflection of financial assistance given to other countries and of military expenditures abroad, was tolerable and even desirable, for it helped a number of countries, mainly in Europe, to strengthen their monetary reserves. In 1957, the U.S. balance of payments moved into a surplus of $500 million, due in large part to the Suez crisis, since the blocking of the Suez Canal required Europe to turn extensively to the United States for supplies of fuel and many manufactured products. But in the years after 1957 the picture was different. From 1958 to 1961 the over-all balance of payments deficits of the United States averaged as much as $3 billion a year, continuing at a high level without much sign of abatement. This was indeed a new situation, at a time when the U.S. economy was exposed to increased trade competition from the other side of the Atlantic and from Japan as a result of the great improvement in the economic and financial position of these other countries. Except in 1959, the United States still had a large surplus on current account in its balance of payments, but capital was able to move much more easily and confidently to Europe and Japan both for temporary purposes and for long-term investment, and the outflow of aid funds continued to be large. It has become a matter of increasing concern for the U.S. authorities to consider how the deficits can be brought down to manageable proportions and eventually eliminated.

In the new situation, therefore, the United States is having to face twin problems: on the one hand, what measures can be taken
to ensure economic expansion and a reduction in the level of unemployment and, on the other hand, what can be done to improve the balance of payments position. The two problems cannot be separated from each other. As the newly reappointed Chairman of the Federal Reserve Board, Mr. William McChesney Martin, said recently before the Joint Economic Committee of Congress: "Balance in international payments is not a goal that monetary policy can pursue apart from its domestic goals. Indeed, the objective of payments equilibrium must be achieved at the same time we are achieving orderly and vigorous economic growth domestically or we will risk achieving neither objective." As regards growth, on the basis of past experience which I have referred to, I believe the most appropriate policy is to combine an expansion of demand—as engendered through the credit system—with a moderation of cost increases. When we turn to the balance of payments we find the same fundamental factors of costs and credit are at the root of the problem, namely, the relationship of costs between the two sides of the Atlantic and also the relationship between the supplies of credit, particularly as affecting movements in interest rates. Is it possible to harmonize the requirements for achieving internal expansion with those needed to alleviate the balance of payments problem?

Let me begin with the cost factor and state here and now that moderation in cost increases is the right policy, both in order to stimulate growth internally and to improve the balance of payments position. One of the difficulties of the United States after the war was that wage costs were relatively high in relation to wage costs in Western Europe. Once war damage was repaired, the main surge of pent-up demand had been satisfied and some currencies not so well placed had been devalued, this differential became very important. Therefore, an equilibrium in exchange relations under the conditions prevailing since 1957 could be restored only by moderation in wage increases in the United States and sharper increases in the European countries, and that is what has been happening. Over the past three years wages in Germany have increased—if account is taken of the revaluation of the deutsche mark—as much

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as 30 per cent in international terms, while the increase here in the United States has been only of the order of 10 per cent in the same period. In other European countries wage increases have not been as high as in the Federal Republic of Germany, but they have been distinctly higher than in the United States. It is perhaps not yet possible to say that on a cost basis an equilibrium has been reached, but the adjustment has certainly gone a long way toward achieving such an equilibrium. So, with regard to the cost factor, there is a natural harmony between the requirements of the internal and external policy objectives.

When we come to examine what is needed in the field of credit policy, it is not quite so simple. In the United States, in order to promote growth at a time when productivity is greatly increasing, it is necessary to ensure increased demand and, as one of the means toward that end, to pursue a policy of easy money, which would help to exert a certain downward pressure even on long-term interest rates. From the balance of payments point of view, on the other hand, tight money and higher interest rates would reduce the tendency for funds to flow out of the country, and would thus help to reduce the deficit in the balance of payments.

It is of course necessary for a stable world monetary system that there should be a proper equilibrium between the money and capital markets, particularly in the field of interest rates, on the two sides of the Atlantic. But this equilibrium can be established in two ways:

(a) by tighter money and higher interest rates here in the United States; or

(b) by a more plentiful money supply and lower interest rates in Europe.

In my opinion, the second line of action is the one to be preferred, although it would necessarily take more time and would consequently tend to prolong the deficit in the U.S. balance of payments for a more extended period than if the first alternative were used.

The reason for my choice is that I think in this new situation which has been emerging it is desirable to avoid a rise in interest rates here in the United States, and also, if possible, to bring down interest rates in several other countries. If interest rates were to be increased in, say, the New York money and capital markets,
such a move would tend to raise interest rates in other sectors, including the mortgage sector, in which the rates, in my opinion, are already on the high side; and it would also militate against any further lowering of the rates outside the United States. The great American economist, Irving Fisher, showed some 60 years ago that when the price level is not rising, but rather somewhat declining, interest rates will be distinctly lower than when the price level was rising. In conformity with what Irving Fisher taught, once the postwar inflation had come to an end and prices became more stable, interest rates would have had to come down generally—and such a downward adjustment is, I believe, a necessary condition for growth. It is interesting to note that in several European countries interest rates have recently been coming down. Since the beginning of the year the Bank of England and the Dutch and Swedish central banks have, for instance, reduced their discount rates—the Bank of England to 4 per cent and the other two to 3 1/2 per cent. I do not think there is any longer any great difference in the cost of lending by commercial banks to first-class customers among the countries on the two sides of the Atlantic.

So, in the money markets of the world, as shown by the movements of the rates of interest, a realignment has been taking place. There are also certain signs indicating again a renewed strength in the U.S. dollar, and the basic reason for this development is, in my opinion, that there are no longer the great divergencies in relative costs and in the credit field that there were even just a few years ago. This does not mean that all is now well with the U.S. balance of payments. In formulating and putting into effect policies to stimulate growth, the balance of payments must be taken carefully into account, but I believe world trends are such that a further improvement in the U.S. balance of payments position is likely this year.

Ensuring Sufficient Demand

In this situation, the means of achieving a truly dynamic economy will have to be considered, in the light of the lessons of the past, in terms of the two dominant factors—a sufficiency of demand and the relation of demand to the level of costs and prices. How are we to achieve the expansion of demand sufficient to match the increased output of a growing economy? Can the expansion be
expected to occur almost by itself, as it did before 1914 (when it was largely due to the impact of a rising gold output) or after 1945 (when it resulted from the excessive liquidity brought about by war financing)? With regard to the possible repetition of the post-1945 experience, I have already mentioned that when world prices began to stabilize some three years ago, one reason was that the wartime liquidity had been worked off. So this would exclude the post-1945 possibility. But what about the impact of a rising gold supply—the pre-1914 solution to the need to expand demand? Thanks mainly to improved technical methods of extraction, gold production in South Africa in 1962 was as much as 11 per cent over the 1961 level, and in the world as a whole, the increase was 7 per cent. This was an unusually high rate of increase. But, even so, the present value of world gold production at $35 a fine ounce is no higher than it was in 1940, and has thus lagged far behind the increase in the dollar value of the national incomes of the countries in the Western world. It is therefore not possible to rely upon the current gold output as such to bring about at best more than a part of the necessary expansion in the credit volume. But having said this, I will not deny that the increasing gold output will help to strengthen the international monetary system, especially as there is a chance that private hoarding of gold will diminish greatly. In 1962—a year full of critical periods (the fall on the stock exchanges, the Cuban episode, and the Chinese attack on India)—hoarding of gold by private individuals and industrial uses absorbed almost three quarters of the newly mined gold and Russian gold coming onto the market. Trends in the gold markets in 1963 seem likely to be more favorable for purchases by the monetary authorities and may enable them to obtain some of the gold they want to acquire to build up their reserves without drawing down the U.S. gold stock.

Since an expansion in demand cannot now be expected to come about by itself, deliberate action is likely to be called for, particularly in the field of credit policy. Central banks have become able increasingly to influence the volume of credit, especially through open market operations. Here in this country the Open Market Committee of the Federal Reserve System, established in 1936, may perhaps with some justification be regarded as effectively fulfilling a central bank's function in this respect. It is by means of open market operations that for over two years a plentiful supply
of credit has characterized the U.S. money markets. But at the same time determined efforts have been made to prevent short-term rates from falling below a level of about $2\frac{1}{4}$ per cent, one main reason being to reduce the outflow of short-term funds abroad.

In these recent years, I have thought that the relatively easy money policy that has been pursued here was the appropriate one, but I want here to sound a warning: while there has to be a sufficiency of credit, there should not be too much! Even in this new situation of more stable prices, there may be periods when some restraint of credit, though temporary, will be necessary to prevent a boom from getting out of hand and leading to a disastrous setback. For even at a time when there is no boom, the availability of too much easy credit may give rise to unwise lending and even provoke inflationary tendencies in particular sectors. Easy money is not a cure-all, capable of coping with maladjustments of structural unemployment resulting from too high wages in certain lines of business, or the consequences of immobility of economic factors. An excessive supply of credit, if it leads to rising costs, may even cause an increase in unemployment. History is full of precedents which show that an expansion of credit can fail to reduce unemployment, even though it leads at the same time to an inflationary rise in prices.

In periods of active business, supported, for instance, by the exploitation of important technical inventions such as occurred with the growth of the automobile industry in the 1920's, easy money alone may act as a sufficient spur for adequate demand. But there may be periods of sluggishness in business when some additional impetus is needed; and it is in such a period that some combination of credit policies, and of fiscal policies, may be called for. I am not suggesting that there should be permanently unbalanced budgets, for such a notion seems to me to be the emanation of permanently unbalanced minds, but in certain given circumstances of sluggish business, a budget deficit may be helpful, ensuring as it does a strengthening of demand. For the current fiscal year here in the United States there is an estimated deficit of nearly $9$ billion, and at the same time a policy of relatively easy money is being pursued. This combination is already in itself an impetus to improvement in business; and the fact that there has been no dip in business either last autumn or early this year may be largely
due to this particular mix of fiscal and credit policy. I am sometimes asked by people from other countries who fear a decline in business activity in the United States whether there will really be a tax cut in the United States sufficient to give an impetus toward economic expansion. I am telling them that already, through the combination of the present budget deficit and easy conditions in the money market, there is a policy that goes a long way toward sustaining business activity.

This does not mean that I think a tax cut is unnecessary in present circumstances. I think it is necessary, even though it must lead to an increase in the budget deficit. It would take too long to give all my reasons for this view: may I only say that the present high rates of taxation both on personal and on corporate income seem to me to be a drag on the economy, and that they should be reduced now that there is a chance to do so, even at a certain risk. This risk may not be too great. Even if we were to assume that the reduction in the tax rates would fail to engender the increase in budget revenue which is hoped for, this country could, if the worst came to the worst, still resort to forms of indirect taxation for the necessary supplementary revenue.

*Control of Costs*

We are thus back to the question of costs. I think it is clear that the role of money, or of credit generally, cannot be considered in isolation but must be related to other factors in the economy, and most particularly to the cost factor. . . . In practice it is no doubt difficult to obtain a freezing of wages; the goal is, therefore, often set to keep the wage rises within the increase in productivity, which will ensure stable prices. Such an approach may be compatible with higher output, but it will not lead to the same reduction in unemployment as would be achieved by the maintenance of stable wages, or wage increases less than the increase in productivity.

In the past it was still generally accepted that wages, because they were flexible, could be left to market forces. Now, with the large organizations of labor unions, and also of employers, it is being felt in more and more countries that there has to be some kind of what in Europe is now referred to as an “incomes policy”—in some countries in the form of officially inspired “guidelines,” in others
by more direct intervention in wage negotiations. An incomes policy, however conceived, should not be regarded as something opposed to the workings of the market system. In my opinion, one of its main purposes would be to facilitate adjustments conforming to the requirements of the market, which cannot any longer be easily brought about by the unaided forces of the market itself.

Let me leave you with just one thought. Economists speak about so-called “long waves”; there was a wave of declining prices from 1873 to 1895; then one of rising prices until 1914; a period of first stable and then declining prices in the interwar period; and then the period of rising prices from 1945 to 1959; and finally now a new situation with stable or even again somewhat declining prices. Almost invariably, periods of declining prices have been those in which tariffs have been increased and other trade restrictions imposed; while in periods of rising prices the tendency has been toward a lowering of tariffs and the removal of other restrictions. The years since World War II have been ones of freer trade; but now perhaps we are coming into a period with fiercer competition when requests for more protection will be put forward with great insistence. If no steps are taken to withstand deflationary tendencies in the present period and a general deflationary trend should set in, these voices would become even stronger and there would be the distinct risk of losing the benefits of the progress achieved over recent years in expanding world trade. This means that the proper conduct of monetary policy, with all its ramifications with regard to fiscal and wage policies, should be looked on not only as it contributes to expanding the rate of growth, but with due attention to all the economic and social side effects which there are in the new situation. Let us not think that matters of monetary policy are of little importance; they affect private lives and official actions often in more subtle ways than is generally realized. If we now have to consider most carefully the need for expansionary policies, the reason is that if we fail to pursue such policies when they are called for, we can easily set in motion forces which may be highly destructive and deprive us of the advantages of a dynamic economy.
The Fund in 1962/63 *

It was six years ago, in April 1957, that I first had the honor to appear before the Economic and Social Council as Managing Director of the International Monetary Fund. It was a time of great difficulties—political and otherwise—mostly centering around the Suez crisis at the end of the previous year. Of particular concern to the Fund were the balance of payments disturbances connected with that crisis and the monetary tension to which it gave rise. But even then I was able to report that those difficulties were already being combated...

Much progress has been made since that time: trade has been extensively liberalized; many currencies have become stronger and all the major trading currencies have become convertible; the monetary reserves of many countries have substantially increased; and the monetary defenses against untoward movements of volatile funds have been greatly strengthened, most prominently by an increase in the Fund’s resources and by the Fund’s borrowing arrangements, but also in other ways—especially through closer central bank cooperation. Economic expansion has continued—unevenly, it is true, but with almost no real setback anywhere—and on the world markets the average level of prices has remained relatively stable for several years. These are real achievements; and while we must all recognize that many difficult questions have not yet been solved, we should be grateful for the positive results that have been attained.

A Difficult Year

The year on which I am reporting today has also been one of difficulties—economic and financial as well as political. This time, the economic and financial difficulties came first: the decline on the stock exchanges on both sides of the Atlantic in the spring of 1962, and then in June the massive outflow of funds from Canada...
at the time of the General Election, and the consequent speculation regarding the value of the Canadian dollar. These events were followed in the autumn by the Cuban crisis and the Chinese attack on India. Then, less than three months ago, came the breakup of the negotiations in Brussels for the entry of the United Kingdom into the Common Market. The last of these events is still rather too close for its consequences to be fully evaluated, but so far as the position of sterling is concerned, I would note that the United Kingdom has a stand-by arrangement of $1,000 million with the Fund. I would like, however, to say something about the other difficulties.

The decline on the stock exchanges was sharper in most of the markets on the continent of Europe than in New York and London. From the peak that had been reached, the average decline in New York was about 23 per cent, in London about 17 per cent, but in Frankfurt and Zürich as much as 40 per cent. Sometimes, and especially when it reflects a fall in dividends and earnings, a sharp decline on the stock exchange has in the past ushered in a recession or a depression (as it did in 1929); but this is not always the case and was not so last year. As we now know, business here in the United States, and even more so on the continent of Europe, continued to improve all through 1962, even after the decline on the stock exchanges, and has continued to do so this year.

The reason why the decline on the stock exchanges was not the forerunner of a recession this time was that it was regarded not as a reflection of worsening business but more as a technical adjustment, brought on by a realization that the postwar inflationary rise in prices had come to an end. Here in the United States, the level of wholesale prices has remained virtually unchanged for five years; and in many other parts of the world, price rises have been less marked than in earlier years and there are no signs of the resumption of any persistent inflation. When, a year or so ago, stocks yielding a very low rate were still bought, it was mostly in the hope of rising yields and higher quotations in days to come, or more simply as a hedge against inflation. The quotations of many securities had risen to fancy prices, and once it was seen that inflation would not continue, these prices had to be corrected, and the sooner the adjustment was made the sounder the position of those securities became. For a time, business in the United States may have been somewhat hesitant, as shown by a disinclination to add much to inventories;
but as demand has continued to keep up, production has been maintained—and in several lines has even increased. It is in the area of what economists call “final purchases” that the increases have occurred which explain the good tenor of business in the latter half of 1962 and in early 1963. These “final purchases”—which exclude inventory changes—consist of goods purchased for consumption, for investment, and for exports, and these goods are thus taken out of the market. In the United States, as well as most other countries, home demand for consumer goods has kept up well, investment has generally not declined, and exports as a rule have risen. In 1962 world trade increased between 5 and 6 per cent, which perhaps more than any other figure shows not only the resilience of business but that the measures taken to free world trade and to ensure prompt payments have had a good effect.

Foreign Exchange Developments

Let me now briefly recall the circumstances surrounding the crisis of the Canadian dollar. Once the election was over in June 1962, the Canadian Government adopted a number of domestic measures designed to alleviate the strain on the balance of payments and turned, at the same time, to the Fund and to institutions in the United States and the United Kingdom for assistance. Four days after the Canadian Government had made its problem known, it obtained a drawing equivalent to $300 million from the Fund, and the equivalent of $750 million was made available from other sources. The combination of the domestic measures taken and financial assistance from abroad proved sufficient to stem the capital outflow and reverse the pressure in the exchange market; Canada has been able over the months that have passed since last June to replenish its foreign exchange reserves in an impressive way, and these reserves are now higher than before the crisis broke. I am also glad to be able to report that in the last few days Canada has announced the removal of all the import surcharges imposed as a temporary measure to help relieve the balance of payments position at the time of the crisis last year. As I am speaking, there is again an election campaign in Canada, but this time it has given rise to no questioning of the value of the Canadian dollar in the exchange markets.
The rapid restoration of the Canadian exchange position was a remarkable demonstration of the effectiveness of the developing international monetary cooperation, and especially of the speed with which assistance can be mobilized in the event of an exchange crisis. Later in the year, when the Cuban and Chinese-Indian disturbances occurred, it was again found that international monetary cooperation was able to play a role. There was, it is true, at that time evidence of strong private demand on the gold markets, but this demand was met without any particular difficulty from current supplies and the London gold pool, and the pressure gradually subsided. The foreign exchange markets, on the whole, remained unruffled by the political events.

On these occasions there was never any doubt about the determination of the monetary authorities—both national and international—to intervene strongly if the need should arise. There was also in the markets an awareness that the authorities now had much more effective methods and larger resources at their disposal if intervention should become necessary: the reciprocal central bank credits which have been and are still being negotiated, and the already-mentioned gold pool in London.

These technical arrangements are valuable in themselves, but fully as important are the discussions from which they have arisen and which will be regularly continued, both in the Fund and elsewhere, to ensure constant review and an up-to-date knowledge of monetary matters among the central banks and more effective cooperation among them.

But what I have to report on particularly here today is the very important strengthening of the International Monetary Fund, which has become effective since I spoke to you last.

Reinforcement of the Fund

In my speech here two years ago I mentioned for the first time in public that circumstances might arise in which the Fund might need additional supplies of certain currencies, and that the Fund was considering the possibility of acquiring such currencies by borrowing. After extensive discussions in the Fund, at the Annual Meeting of the Fund’s Board of Governors in Vienna, and later in Paris, the basic provisions of the borrowing arrangements were incor-

2 See above, page 223.
porated in a decision which the Fund adopted and published in January 1962 under which, as you will recall, the ten main industrial countries concerned indicated their willingness, on their adherence, to lend to the Fund amounts of their currencies, totaling in all the equivalent of $6 billion. I reported on this development a year ago. But at that time there still remained the adherence of the individual countries to these arrangements, which in most cases required formal ratification by their Parliaments. Commitments totaling the equivalent of $5 1/2 billion on the part of at least seven participants were necessary to bring the arrangements into effect. This was achieved on October 24, 1962, when the formal adherence of the Government of the United States was received, following the adherence earlier in the year of seven other countries. Total commitments then amounted to the equivalent of $5,650 million, so on that date the Fund's general arrangements to borrow became effective. Of the two remaining countries, Belgium has subsequently adhered to the arrangements, but Canada, where two elections have intervened, has not yet done so. It is perhaps worth mentioning that in cases where Parliamentary approval has been required, it has been obtained with virtually no opposition, which is, I think, an indication that the arrangements are generally admitted to be useful. Switzerland, which is not a member of the Fund, was invited by the Fund to become associated with these arrangements, and following consultations between the Fund and the Swiss Federal Government a bill has been submitted to the Swiss Parliament within the past month proposing that Switzerland enter into an understanding with the Fund providing for Swiss association with currency support operations of the Fund in an amount equivalent to a maximum of $200 million.

Whenever requests for financing assistance are made which would make it desirable for the Fund to supplement its resources by borrowing, the requests will be assessed in accordance with the Fund's accepted policies and practices governing the use of its resources; and drawings involving such supplementary resources, like other Fund drawings, will be repayable to the Fund as and when the member's problem is solved, and in any event in not more than three to five years. The borrowing arrangements thus fit smoothly into the framework of the Fund's principles and practices as they

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3 See above, pages 271-72.
have been developing over the years. What is new is the commitment of the participating members to lend to the Fund to enable it more effectively to forestall or cope with a threat of impairment to the international monetary system. That framework has been further consolidated by other steps taken in connection with the work to strengthen the Fund, which culminated in the borrowing arrangements. In July 1961, the Executive Directors had clarified the Fund’s role in relation to the use of the Fund’s resources for coping with deficits attributable in greater or less degree to capital transfers, and in July 1962 they took a decision setting out the principles which should govern the choice of currencies in drawings and repurchases. It is also pertinent to recall here that in 1959 the Fund’s resources were strengthened by means of a general increase in members’ quotas, of not less than 50 per cent but in several cases substantially more, which raised quotas from a total equivalent to $9 billion in 1958 to an amount equivalent to $15 billion at the end of 1961.

With these increased financial resources at its disposal, the Fund is confident that it will be able to play a decisive role in rendering assistance to both large and small member countries in their efforts to pursue policies compatible with the Fund’s principles and practices. At the same time, the resources are substantial enough for the markets to realize—as I think they have done—that speculative movements of funds in themselves cannot reach proportions large enough to overcome the defenses now existing when they are effectively applied. I have noticed over the last year, in the financial pages of newspapers in various countries, often rather astonished comments about the relative calm of the foreign exchange markets, and again and again it has been pointed out that the capacity of the Fund to give massive support is one of the decisive reasons for the calm that has prevailed.

Economic Coordination

So, defenses have been built up to ensure more effectively the stability of the present monetary structure; but stability is not the only problem. To cope with rapidly growing production and

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4 See above, page 247.
5 See above, page 287.
economic activity generally, an expansion in liquidity is needed, not so much in terms of the adequacy of monetary reserves—what is often called “international liquidity”—as in the liquid means available in the most important national currencies and the monetary purchasing power into which they may become translated.

There have been periods in world history when the generation of sufficient monetary purchasing power has raised few problems. Such a period has been the one we have just passed through—the period after the Second World War when the hang-over of excessive war liquidity produced a volume of purchasing power that in fact was inflationary. In the speech I made here six years ago, in the spring of 1957, a continued inflationary rise in prices was still a very real threat; I mentioned in that speech that in the United States consumer prices had risen by 3 per cent in 1956, in the United Kingdom by 4 per cent, and in certain other countries at an even higher rate. But this period was already drawing toward its close, and within the following two or three years the basic conditions on the world markets had radically changed. Supplies caught up with demand, and under the impact of fiercer and fiercer competition the continual upsurge of prices of many commodities came to an end. Not every country has been drawn into this new situation to the same extent, but the new competitive forces are making themselves felt in more and more countries.

In this new situation, new policies and practices were needed, and I shall mention two in particular:

Firstly, when prices could no longer be raised, greater attention had to be paid to costs. It was not always very easy to convince the public, or even the business world, that a radical change in the general economic situation had occurred. Consequently, economists and policy makers had to adjust their thinking to the new situation and explain its implications to their public and parliaments. Of particular importance is the thorny question of wages. It was therefore a valuable service when, in the United States, the Council of Economic Advisers, in their report to the President early in 1962, set down the “guideposts” or “guidelines” for what they considered to be permissible wage increases—in general, the keeping of the increases within the margin of increases in productivity.  

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Gradually, in other countries, the need for some similar guidance made itself felt, and in many countries, statements have been issued over the past year containing indications of what should be considered appropriate principles for the determination of wage increases in relation to increases in productivity, movements of prices, and other relevant factors. Such statements have often been discussed in terms of a beginning of an "incomes policy." For most countries, even the issuing of guidelines is a new departure in the field of official policy and, at the same time, in the field of their economic thinking. The announcement of such guidelines or the elaboration of an "incomes policy" need not run counter to the requirements of the market economy system; on the contrary, in present-day economies, often tending to be dominated by the development of increasingly large organizations and groupings of industry and labor, some guidance may be very necessary in order to establish certain basic conditions for the proper working of such a system.

Secondly, a new factor affecting official policies in the new situation is—as I have already pointed out—that it can no longer be taken for granted that an adequate increase in liquidity or in monetary purchasing power will occur without special action. To some extent, of course, business may use its own liquid resources more freely and request increased credits from the banking system, which will help an expansion, but such developments have at least to be underpinned by official policies. The United States, as you know, has in recent years been pursuing relatively easy money policies and, at the same time, the federal budget has been in deficit and the budgets of the states and local authorities have required a great deal of borrowing. In addition, certain specific measures have been taken—the liberalization of the depreciation allowance and the 7 per cent tax credit—and they too will help to sustain demand. Because of the balance of payments situation, the expansionist policies of the United States have involved a certain risk, but I think that the risk has had to be taken, for a nonexpansionary policy at the present time in this country, with its very powerful economy, could have had a serious effect on the level of economic activity in the world as a whole. As you know, the President has also proposed a tax cut which, if adopted, will intensify the expansionary character of U.S. economic policies. All these policies have been followed and
these new proposals introduced because they were considered to be in the interest of the United States, but the United States is so important in world affairs that policies undertaken here have wide repercussions abroad.

In addition to outward-looking policies by the Government of the United States, there should be a coordination of the economic policies particularly of the main industrial countries, and I believe this is a movement which may well be developing. It is beginning to be realized that coordinated economic policies are more and more needed in this new situation, and that they serve the interests not only of the more highly developed economies but also of the raw material producing countries all around the world. Continued economic expansion in the industrial countries is of great importance to the less developed countries, both because it tends to lead to an increase in the purchases of raw materials by the expanding industrialized economies and because it usually results in an all-round stimulus to world trade, which should also help the exports of primary producers' developing industries. This Council is, of course, aware in its debates of the fact that the main trend of economic policies of the industrial countries is also very much the concern of the less developed countries.

Fund Operations

The Fund has had some very large transactions with a few of the highly industrialized countries—transactions which have attracted great attention, and deservedly so. But the Fund's transactions with less industrialized countries in different stages of development have been very much more numerous. The Fund has, for instance, had transactions with all but one of the 20 Latin American Republics; and in the last year all but one of the drawings and all but one of our existing stand-by arrangements were with developing rather than industrial countries. Normally, the close contact between the Fund and the member country has extended over several years and has led to a very intimate knowledge of the country's problems and what assistance the Fund can most usefully provide. Experience varies, of course, but the Fund has been impressed by the efforts made to establish and maintain orderly monetary conditions in a great many countries, even under great difficulties.
One of the difficulties that have plagued particularly the less developed raw material producing countries has arisen from fluctuating prices for primary products, creating instability in the export earnings of these countries. It is, of course, part of the Fund’s regular function to provide its members, including its primary producing members, with financial assistance to meet short-term fluctuations in their balance of payments, including those caused by fluctuations in exports. In recent years, in which there has been a marked increase in the total amount of Fund assistance provided to the less developed countries, there seems to have been an increase in the proportion of cases in which the difficulties have arisen at least in part from declining or stagnant export proceeds. It has been estimated that, by and large, the short-term fluctuations in the exports of primary exporting countries are some 30-40 per cent greater than those in the industrial countries. Since many of the primary exporting countries are short of reserves, they are not able to cushion the effect of these fluctuations on domestic production and prices, and they frequently find it difficult to sustain the importation of capital goods required for a steady program of development.

For a number of years much thought has been given, in international forums and elsewhere, to ways in which useful assistance could be rendered to countries affected by variations in their export earnings. The Fund has followed these discussions closely, and, after a thorough consideration of the problems involved, has taken certain decisions by which it has determined what further contribution it can make in the financial field.

Compensatory Financing

On February 27 this year, the Fund took the decision to create a new compensatory financing facility which would broaden its balance of payments support of member countries, and particularly those exporting primary products. This new facility, which would normally amount to 25 per cent of the member’s quota, would enable the Fund to grant assistance more readily in cases of payments difficulties produced by export shortfalls of its member countries. The Fund would have to be satisfied, in the first place,
that the shortfall was of a short-term character, and largely attributable to circumstances beyond the control of the member country. Often such a shortfall would be the result of price fluctuations related to cyclical conditions in the industrial countries, but it might also be the result of a particularly bad harvest, or even of a natural calamity, such as an earthquake; so the causes can be many. Secondly, a member country would need to show willingness to cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties. This does not mean that there has to be an approved program already worked out before the drawing. But the country would discuss any balance of payments problems with the Fund with a view to coming to positive results; and it has been more and more the experience of the Fund that the member countries, in their own interest, are anxious to follow this course and indeed do so of their own volition. This new facility will not reduce the amount of assistance available under the Fund’s ordinary drawing policies, because the Fund has stated that it will be prepared to grant a waiver and permit outstanding drawings to exceed an amount equal to 125 per cent of quota where this is necessary in order to facilitate its policies on compensatory financing.

The general intent of the new facility is to give all member countries which desire to solve their balance of payments problems the assurance of ready Fund support in meeting difficulties arising out of genuine short-term shortfalls of exports. The application of the new policy will have to be worked out on the basis of experience, and I am sure it will be done in an atmosphere of friendly cooperation between the Fund and its members. It is my belief that this new facility will prove both directly and indirectly to be the basis of genuine assistance to, and cooperation with, the less developed countries pursuing a steady course of development.

The same decision also dealt with the possibility of raising quotas for certain primary producing countries, particularly those with relatively small quotas, in order that the quotas for these countries might be made more adequate in the light of fluctuations in their export proceeds and other relevant criteria.⁹ The Fund will be making a closer study of this subject in the coming months.

The decision has been embodied in a report prepared in response to an invitation from the Commission on International Commodity Trade in May of last year. The report, which has been transmitted to the United Nations, clearly states that such financing is only one of the means of improving the condition of the less developed countries. In addition, action in many fields is required, and such action has to be taken by the developing countries themselves as well as by the industrial countries and international institutions.

National Responsibilities

In this work there has to be a division of responsibilities—not necessarily the same in all cases. There also has to be a determination by all concerned to work hard to ensure sustained development. Let me begin by saying something about the responsibilities of the industrial countries.

In the first place, the industrial countries, to the maximum extent possible, should both permit and encourage ready access to their markets for the products of the developing countries, including such products of new industries as these countries may be able to export on a competitive basis. This whole subject is, of course, closely linked with general trade policies, a subject, as we know, now very much under discussion in different parts of the world; in particular in GATT—with which the International Monetary Fund has special relations—and also in the United Nations, where the Preparatory Committee for the International Conference on Trade and Development, in which the Fund is participating, is currently considering some aspects.

Secondly, the industrial countries have a responsibility to provide sustained technical and financial assistance to the less developed countries. In regard to financial assistance, I believe there is a growing understanding among the general public in the more advanced countries of the appropriateness of such assistance, and this attitude is shared, I think, by most governments; but, at the same time, there is a feeling that the assistance should be used more effectively. Personally, I do not think that over the years the amount of aid given is likely to be lessened by a critical review of how it can be most effectively utilized. On the contrary, I believe that such a review is the best way of ensuring a continuation of the aid.
Thirdly, I would repeat what I have already said earlier today, namely, that general policies of an expansionist nature, pursued by the leading industrial countries, are of great importance for the less developed countries since they lead to a strengthening of the demand for their products.

Let us turn now to the less developed countries: they have, of course, the responsibilities of sovereign states to conduct their own affairs, maintain law and order, educate and care for their people, administer their finances and their economy. In conducting their affairs, they have the responsibility of framing their policies in such a way as will contribute best to the growth and development of their countries. The less developed countries differ, of course, from one to another in the extent of their resources, their rate of development, and in as many other ways as industrial countries do. It is therefore not easy to generalize, but some observations may, I think, be made, and I want to address myself particularly to the problem of development.

To promote industrial development and the setting up of new businesses, two things are needed: on the one hand, men who have a spirit of enterprise and the technical knowledge necessary to initiate new projects or develop existing plant; on the other hand, free resources—in other words, savings—to finance genuine and lasting development. In this connection it is instructive to study the state-controlled economies of the communist countries; the leaders of these countries found, very soon, that they needed real savings, which meant that they could not allow the country's production to be fully used up for consumption but had to reserve a part—and often a considerable part—for productive investment. So, whether economies are run on a collectivist or market system or some kind of mixed system, they all have to pay heed to fundamental principles of economics.

There will be foreign aid forthcoming for less developed countries, and it will, of course, be important, but foreign aid will at best play only a limited role in relation to the total needs. No country has ever developed except largely through its own savings. This means that the less developed countries themselves will have to examine most assiduously what savings they can mobilize from their own resources.
I cannot go into detail here concerning the most suitable tax and expenditure policies for developing countries. I shall only say that in these matters outside expertise can often be useful, and I am glad to be able to mention that the Fund is substantially expanding its services in the field of technical assistance, which will enable it to increase the expert assistance that it now provides to member countries on fiscal, credit, and monetary matters.

**Dangers of Inflation**

Countries with limited real resources often feel a great temptation to rely excessively on the banking system, and especially on the central bank, to finance expenditures by creating money, that is, by inflation. I think by now it has become sufficiently widely known that the incidence of inflation is such that the burden of it falls mostly on the poor, for whose benefit primarily, I had always understood, development policies are undertaken. But in an inflationary period, the wage earners will seek, and most probably obtain, frequent wage settlements, perhaps as often as every few months. In such circumstances, it will be less and less possible to squeeze any resources out of the public at large, and the likelihood is that the inflation will be turned into the galloping kind, with all the destructiveness of such a process.

Moreover, it is too easy to assume that the resources so diverted by inflation would all go into development. Inflation gives rise to windfall profits and capital flight, which no system of controls seems capable of arresting. As a result of such capital flight, an inflating country will not be able to retain for its own use all of the forced savings it may squeeze out of its people, much less provide any inducement to investment or assistance from abroad. Furthermore, inflation very often leads to an overvalued currency with all the consequent harm and distortions to the economy which result from such a situation.

At the Fund's Annual Meeting in September 1962 in Washington, a considerable number of the Governors of the Fund, particularly those from the developing countries, addressed themselves to these issues of stability and development, and it was interesting to note with what unanimity the Governors declared that in their opinion inflation was most harmful to their economies, and certainly harmful to growth.
Theirs were general pronouncements, but I can assure this body that the Fund, in its regular consultations and other contacts with member countries, has found that these sentiments are gaining ground decisively, even, I find, among the relatively few persons who have resisted them hitherto. More and more countries are taking the measures needed to ensure the success of policies aimed at stabilizing the economy, even though it is realized that this may require a period of readjustment until a new balance is attained from which sustained growth can be resumed. I should add here that, according to the experience of many countries, such a period of adjustment need not be either very harsh or very long, especially with the support from international institutions and friendly governments, which it is reasonable to expect will be forthcoming to back up the countries' own determined efforts. When the new period of growth sets in, it will be more firmly founded.

I can understand the feeling of disappointment in many countries, where the per capita income is desperately low, that there is not some easy method, such as deficit financing, available to speed up the rate of growth. But there is no such method either in the collectivist economy or in the free market economy, or whatever combination of the two systems is used. The difficult problems of growth require much detailed and hard work of a constructive character in many fields. These problems are best grappled with under stable monetary conditions and from a firm base; and to enable countries to do so, there should, and I hope will be, available from the Fund and elsewhere the technical expertise necessary to assist national authorities to develop to the full the resources at their disposal.

Role of International Agencies

It is good to know that there are many international agencies available to give valuable assistance to these countries, both here in the United Nations itself and in the various specialized agencies. I must, of course, mention first the very important role which the International Bank for Reconstruction and Development and its affiliates play in responding to the aspirations of the developing countries. I would also like to pay special tribute to the valuable work which has been, and is still being, done in many member countries by Mr. Hoffman and the Special Fund, by Mr. Owen
operating through the expanded program of technical assistance, as well as by other similar organizations whose work touches upon that of the Fund, all of which have, of course, as the central forum for the discussion of their problems the Economic and Social Council of the United Nations.

Beyond the technical help from these sources, effective assistance to the developing countries must include, in my view, when the proper basis has been laid, the readiness of the richer countries to give appropriate aid in the three forms I have mentioned earlier—financial assistance, technical assistance, and the opening of their markets to the products of the developing countries.

This is the last time I shall appear before the Economic and Social Council as Managing Director of the International Monetary Fund. I would like to say how much I have appreciated the friendly relations which have existed between the Fund and the United Nations. My contacts with the Secretary-General himself and with Mr. de Seynes and his Department of Economic and Social Affairs have always been most cordial. I would also like to say to the members of this Council how useful and enjoyable it has been to discuss here in this forum problems of common concern to the Council and the Fund. I feel that questions have been discussed with great frankness and a constructive spirit, and I am sure my successor will continue to regard this occasion as a major annual event in the relations between the Fund and the United Nations.
APPENDICES
### Articles and Books by Mr. Jacobsson, 1957-63

#### Articles

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¹ For list of reprinted speeches, see *Notes to Speeches*, page 355.
Articles and Books (continued)

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**Books**


1963 *The Role of Money in a Dynamic Economy* (Graduate School of Business Administration, New York University; Reprint of the Arthur K. Salomon Lecture, 1963—see above, page 310)

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2 See above, page 1.
3 Above, page 18.
5 Above, page 35.
6 Above, page 49.
7 Above, page 67.
9 Reprinted in Foreign Affairs (New York), April 1959, as “Toward More Stable Money.”
10 Above, page 81.
11 Above, page 95.
13 Above, page 111.
14 Above, page 117.
15 Above, page 127.
16 Above, page 146.
18 Above, page 162.
19 Reprinted in Medunarodni Problemi (Belgrade), Vol. 12 (1960), No. 4, pages 159-69, as “Renesansa monetarne politike.”
20 Above, page 178.
21 Above, page 187.
23 Above, page 204.
26 Above, page 215.
27 Above, page 226; reprinted in Kyklos (Basle), Vol. 14, Part III.
28 Above, page 237.
31 Above, page 268.
32 Reprinted by Central Bank of Egypt (Cairo), 1962.
34 Above, page 283.
35 Above, page 298.
36 Above, page 310.
38 Above, page 328.
1945 Dec. International Monetary Fund established
1947 Mar. Fund opened for exchange transactions
1947 Apr. GATT established
1948 Apr. United States inaugurated European Recovery Program ("Marshall aid")
1948 Apr. Organization for European Economic Cooperation established
1949 Sep. Major European currencies devalued
1950 June Korean crisis begun
1950 July European Payments Union established
1951 July Cease-fire negotiations begun in Korea
1952 Feb. Fund Executive Directors' Decision on Use of Fund Resources (use to be limited to 3-5 years)
1952 Oct. Stand-By Arrangements introduced by Fund
1956 Oct. Suez Canal closed
1956 Dec. Mr. Jacobsson assumed office as Managing Director of the Fund
1957 Mar. Treaty of Rome signed (for establishment of European Economic Community)
1957 Apr. Suez Canal reopened
1957 June Fund Executive Directors' Decision on Multiple Currency Practices
1957 Aug. French franc devalued
1958 Jan. European Economic Community established (Treaty of Rome came into force)
1958 Dec. French franc devalued; stabilization program introduced
1958 Dec. Principal European countries introduced external convertibility of currencies
1958 Dec. European Payments Union replaced by European Monetary Agreement
1959 Oct. Fund Executive Directors' Decision on Discrimination for Balance of Payments Reasons
1959 Nov. European Free Trade Association Convention signed
Chronology (continued)

1960 May  European Free Trade Association established (Convention entered into force)
1960 June  Fund Executive Directors' Decision on Transition from Article XIV to Article VIII
1960 Oct.  Inter-American Development Bank began operations
1960 Oct.  Gold price in London market increased temporarily to $40
1960 Nov.  President Eisenhower issued Directive designed to reduce the deficit in the U.S. balance of payments
1961 Feb.  President Kennedy sent Message to the Congress on Balance of Payments and Gold
1961 Feb.  Nine European countries and Peru accepted the obligations of Article VIII of the Fund Agreement (convertibility of currencies)
1961 Mar.  Value of deutsche mark and Netherlands guilder increased 5 per cent
1961 Mar.  Short-term credits granted to United Kingdom by European central banks because of heavy pressure on sterling
1961 Mar.  Statement issued by Governors of European central banks that rumors of further currency changes were unfounded
1961 June  Latin American Free Trade Association established (Treaty of Montevideo entered into force)
1961 June  Canadian Government announced intention to reduce the exchange rate of the Canadian dollar
1961 July  Fund Executive Directors' Decision clarifying the use of Fund resources for capital transfers
1961 July  U.K. Government announced comprehensive program to strengthen sterling; $1.5 billion transaction with Fund
1962 Jan.  Fund Executive Directors' Decision establishing the General Arrangements to Borrow
1962 May  Fixed value for Canadian dollar re-established
1962 July  Fund Executive Directors' Decision on Currencies to Be Drawn and to Be Used in Repurchases
1962 Oct.  Fund General Arrangements to Borrow became effective
1963 Feb.  Fund Executive Directors' Decision on Compensatory Financing of Export Fluctuations
1963 May 5  Death of Mr. Jacobsson
Chart 1. Indices of the Volume of Exports, Annually, 1950-62
(1958 = 100)


Chart 2. Indices of Prices of World Exports, by Commodity Classes, Annually, 1950-62
(1958 = 100)

Chart 3. Gold and Foreign Exchange Reserves at End of Year, 1947-62
(In billions of U.S. dollars)

Chart 4. Outstanding Balances of Drawings from the International Monetary Fund, and Unused Stand-By Arrangements, on April 30, 1948-63

(In billions of U.S. dollars)

Source: International Monetary Fund.

Countries in the European Economic Community and the European Free Trade Association (except the United Kingdom), Canada, and Japan.
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to give some idea of the range of his reflections.

The circumstance that Mr. Jacobsson delivered a series of major addresses at approximately half-yearly intervals enables the reader to re-create the changing economic environment of the years 1957-63 as it appeared from month to month to an exceptionally acute observer with unusual facilities for seeing behind the scenes. The Executive Directors of the Fund believe that, if for this reason alone, the collection will be of interest and value.

The volume includes a table giving the dates of the chief events mentioned by Mr. Jacobsson and charts summarizing the changes in trade, prices, and reserves which influenced the world economy during the relevant years.