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CURRENT PROBLEMS IN INTERNATIONAL FINANCE

Dr. Frank A. Southard

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Reviewed by Col R. W. Bergamyer, USAF on 18 November 1963.

INDUSTRIAL COLLEGE OF THE ARMED FORCES

WASHINGTON, D. C.

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GENERAL STOUGHTON: Gentlemen: The title of our lecture today, "Current Problems in International Finance," indicates that there are some other problems besides the much-discussed U. S. balance of payments.

Our speaker, Dr. Frank A. Southard, Jr., Deputy Managing Director of the International Monetary Fund, deals in this larger world of international finance, where the balance of payments is simply one of the problems.

As indicated by his biography, he is eminently qualified to discuss this topic today.

Dr. Southard, it is a pleasure to welcome you to the Industrial College.

Gentlemen, Dr. Southard.

DR. SOUTHARD: Thank you, General Stoughton. Officers and Members of the Class: I am very glad to be here. But not since my earliest college days, when I went to a little school where the first class was at 7:30, followed by chapel, have I even dreamed of the possibility of lectures occurring at unholy hours like this. So that this is for me an experience that I haven't had since 1925, because juniors and seniors at my college didn't have to come to the 7:30 classes.

I have, I am afraid, a long assignment. I have done my best to work out some comments following the short outline in your book. But of course it is by the nature of the subject a tremendous one, and I won't be able to do very much but skate over the surface. I told General Stoughton in the original correspondence that I was not prepared, as now an international civil servant, to come before you and spend the whole time talking about the balance of payments problem of the United States or anything similar, but that I would be prepared to talk about current problems in international finance. I will possibly get on to the edge of the U. S. balance of payments problem and the position of the dollar as a reserve currency.

I would start with a few words about the nature and function of the International Monetary System, because, what the Fund deals with and indeed the subject with which most people in my field are preoccupied nowadays is the functioning of the International Monetary System and the question of whether that system is adequate to meet the strains that it is carrying, or even if it is adequate now, whether in looking down the road we can imagine that it needs to have some strengthening.

This system, which is the international counterpart of the domestic monetary system, consists of three main elements: The foreign exchange mechanism that enables countries, each of them having its own currency, yet to deal with each other and to smoothly convert transactions in one currency into the other currency.

Secondly, credit facilities, especially short-term credit facilities, but, of course, as well, intermediate and long-term facilities.

Thirdly, reserves and other forms of official liquidity.

Now, if we mix up those three elements, we necessarily have some form of system which operates smoothly enough, as it obviously does, to enable the world to carry on an extremely large mass, upwards of #100 billion, of international trade, international capital movements, tourist ecpenditures, shipping, insurance, and everything else that goes to make up the great network of world transactions.

The present International Monetary System is based on what we could call a currency-exchange standard or a dollar-sterling exchange standard. One could stretch it a little bit, I suppose, and call it a dollar-sterling-French-franc exchange standard, since the French franc, within the French zone, the former colonial area of now largely independent countries, also serves as a reserve currency.

But, of these three, if we include the franc, reserve currencies, the most important is the dollar, although sterling is not to be minimized, and this does point to the role of the dollar as a key currency. By a key currency we mean a currency which other countries are using as reserves and in which other countries carry out a substantial mass of transactions.

You can have a very good currency, such as the Deutchmark, or the Dutch guilder, but you find on inspection that virtually no international transactions are being carried out in that currency. International transactions are generally carried out in one or another of the key currencies.

The function, then, of this delicate mechanism in the world of the International Monetary System is to enable the world trade in goods and services and the world movement of capital to continue to expand in pace with the economic growth of the aggregate of the world economies; and, secondly, to permit countries to finance disequilibria in their balances of payments.

Now, disequilibria in balances of payments can be, as the little outline indicated, chronic or they can be temporary. Unhappily, in the kind of business that I work in, it is not always easy to determine whether we are dealing with a chronic or a temporary disequilibrium, when something that starts out to be temporary may turn out after all to be chronic. This often causes a good deal of trouble.

The very fact that one talks about disequilibrium and raises the possibility that disequilibria in balances of payments can be chronic or temporary, raises the extremely difficult and complex question of the mechanism of adjustment of the balance of payments. Theoretically there should be no such thing as chronic disequilibrium in the balance of payments. If we go back to the classical concept of the old gold standard, a country whose total credits and total debits on international account, in a given period such as a year, did not balance without the necessity of moving gold as a balancing item, was in a disequilibrium situation in which the inflow or outflow of gold net was expected to have, in theory at least, very powerful adjusting effects, powerful effects on the credit structure, on the rate of interest, up or down, and, therefore, finally, on the cost-price structure of the given country, compared with the world cost-price structure. These general forces would tend rather promptly toward equilibrium. So that the movement from equilibrium to disequilibrium and back to equilibrium, in concept, in the old gold standard, was one which could operate very swiftly indeed.

Now, whether it did or not is a matter of a lot of controversy. Some men have written good books to show that it did work that way, and others have written equally good books to show that it didn't work that way. But in any event there was in that system the mechanism of adjustment which did operate quite powerfully.

The more nearly countries have moved away from a species standard into a managed standard, a managed currency both at home and internationally, the more that judgment has entered into the operation of economic affairs, the more complicated economies have become, the more conflicts of national policy have arisen--powerful labor unions with their wage pressures, powerful farm lobbies that have built farm-support policies, and so on--the more all these things have happened the more sluggish the mechanism of adjustment has tended to become. We can therefore now see all around us in the world cases of disequilibria in balances of payments which very obviously reflect a great deal of lag or friction arising out of a set of accidental circumstances or a set of deliberate policies which mean that countries can for a long time be in a situation of disequilibrium which can result in exchange fluctuation and exchange depreciation, in exchange controls, as the country squirms and struggles to either stay in a situation of disequilibrium and live with ir or painfully adjust to it.

I am ashamed to try to deal with a colossal subject of that sort in so few words, but what I want to leave with you is that this general problem of disequilibria in balances of payments is ever present in the International Monetary System.

Now, no international monetary system can deal with chronic balance-of-payments disequilibria. There is no system that operates on the basis of any kind of adjusting mechanism, with provision for emergency relief or supplementing reserves, and so on, which can cope with a persistent disequilibrium in a given country. All that an international monetary system can do is to provide some easement for disequilibrium to a certain limit, an undefined limit, beyond which the individual country will find itself, in a sense, left alone to struggle with the problem of disequilibrium without reference to the possibility of the international monetary system giving it help.

One of the major issues in the great current controversy among economists over what should be done to remake or improve the international monetary system lies right here in this question of the extent to which the international monetary system should have built into it means of helping countries to live with disequilibria in their balances of payments. If I epitomize the central issue here, it seems to me to be this: To what extent should creditor countries in a given situation, a given time in the world, have placed on them through the international monetary system the burden of carrying debtor countries, no matter what the nature or what the cause of the debtorship is.

In its crudest form this controversy, as it is seen by the conservative, central banker, let's say, in Western Europe, amounts to saying, "Shall the well behaved creditor countries have to carry the badly behaved debtor countries year after year?" The answer that they would have to give this question, of course, is no. The answer that some other people would give would be yes, in varying degrees, although even the most enthusiastic reformer in this field will agree that no system can be expected to carry badly behaved countries that are in a debtor position, that is to say are in a situation of chronic disequilibrium indefinitely.

But, what one does to equip the International Monetary System to deal with bad boys in this field, bad countries, and what powers of discipline it can be given, the powers of authority to say yes to a good debtor country and no to a bad debtor country, make one of the most difficult problems in the evolution that we are now going through with and I think we will be going through with in the next 10, 15, or 20 years.

So much for the disequilibrium as it merges as a central element in world finance. Let me turn very briefly to to the world payment situation as it exists currently or at least at it looks at the end of 1962. This is an extremely broad and quick glimpse of this complicated payment situation, but on that basis I would put it about as follows:

In terms of goods, services, and private transfers the United States had a position of about plus \$4 billion. The European industrial countries had a position of about plus \$2 billion. The United Kingdom and Japan were very nearly in balance. The total of the primary producing countries, or the so-called less-developed countries, or LDC's, was about minus \$6 billion. This is, of course, what the arithmetic ought to add up to. This is in terms of goods, services, and private transfers.

If we now put this in terms of the so-called basic balance, that is, goods, services, private transfers, and long-term capital or grants--foreign aid, that is, private and public--we then find something like this: The United States in a minus \$2 billion position, Western Europe, excluding the UK in a plus \$1 billion position, the UK and Japan about in balance, and the primary producing countries in a plus \$1 billion position.

So in that sense the United States, with a position of minus \$2 billion, if you want to put it in these terms, was carrying the roughly \$1 billion surplus of Europe and of the LDC's. Now, the United States deficit position in basic balance, as I just mentioned, is accentuated by short-term capital movements. So in 1962 our basic balance in this country was \$2 billion minus, and you add approximately something less than a billion more--say \$800 million--the minus balance for short-term and unrecorded transactions, and the unrecorded ones would probably be short-term capital outflow, and you get us up to not much short of a \$3 billion deficit.

Broadly, then, the world payment as it looks today is something like this: The LDC's, as we would expect of a group of countries that are by nature capital importers, are in deficit. That's to be expected. Continental Europe is in surplus, which in a sense maybe is not to be expected, but there it is. The United States is in deficit because we have been providing capital to the LDC's on a more lavish scale, or at least a larger scale, than has Europe, and we have been investing abroad very generally all around the world.

Now, the balance of payments problem of the United States, which is built out of those ingredients, is of concern both to the United States, obviously--because it's our problem and it's our currency that's involved--and to the rest of the world because the United States dollar is the great reserve currency and because this overall net deficit position of the United States has for the last 10 years been the surest provider of net liquidity to the world through the International Monetary System.

The essence of our balance of payments problem can be put simply enough. It is: How can we generate a big enough surplus on current accounts--that is goods, services, and private transfers--to cover the capital outflow which is made up of private investment abroad and public loans and grants, the latter comprising one of the big elements in our national economic policy, but the private investments themselves also being for us, as a great industrial power, a legitimate and a highly desirable part of our total United States investment at home and abroad in a given year? It's a stubborn problem. It's one that at times like a few months ago, really, even at the end of the second quarter, has assumed almost crisis proportions--never quite but almost--but, nevertheless there are some signs of improvement, not only the sort of temporary sign of improvement--if it is temporary--in the third quarter which has greatly relieved the minds of the U. S. public officials and is due in part, at least, to the impact of the equalization tax proposal which has tended to discourage, for the time being, the outflow of long-term capital, but there are also some signs that Western Europe, the strong countries of Western Europe, chiefly in the Common Market, are moving into a less strongly accentuated surplus position.

For example, taking the current account balance alone, of the Common Market Countries, the Six--you'll remember it includes little Luxembourg, but otherwise it's the five larger ones--in 1958 it was the equivalent of $2.6 billion surplus. In 1959 it was $3 billion. In 1961--to jump over a year--it was $2.5 billion, and in 1962 it was only $1 billion. I should say that in 1963 it looks on the whole as if it might be rather above the $1 billion. On the other hand there are some cases like Italy, which probably are adjusting rather quickly into a position of possibly deficit, so that it is too early to tell whether it will be greater than $1 billion.

Let me now turn briefly to the role of the IMF and then very quickly to a few words on the whole liquidity issue. Then I trust that your questions later may develop some of these points.

Well, I have talked at times an hour on a lecture of this sort on the role of the IMF. It's not an easy subject to deal with very quickly. The Fund is an international institution, answerable to 102 governments, but with the larger governments by a weighted voting basis having the largest voice.

Our assets belong to us in the Fund legally. The Fund articles of agreement constitute, in the laws of the member countries, part of what we would call in this country the law of the land. They are as binding as a treaty. In our case they are an act of Congress, not a treaty, authorizing the U. S. adherence to the articles of agreement, and U. S. courts have repeatedly ruled that the provisions of the articles of agreement are enforceable in the courts of the United States. This is, of course, one of the strengths of the International Monetary Fund. It's an institution that has power given to it by its articles of agreement.

It is also an institution with a lot of money. There's nothing like a lot of money to give you power, as most of you either know or have been told. The Fund has, broadly, a two-fold mission. First, we administer what I call a code of fair practice in the field of international finance, which is written into the articles of agreement. The countries are supposed to have a convertible currency based on a par value, free of restrictions, and they are not supposed to change their par value and therefore their exchange rates unless they have a legitimate reason for doing so, that is to say unless they've got a fundamental disequilibrium which needs to be corrected.

The Fund has the power to approve or disapprove changes in par value, to approve or disapprove restrictions on payments, and the Fund has got enough power to have an impact, although this is an imperfect world and the exercise of power, as you know in your own military work, is not a perfect thing but a very imperfect thing.

Secondly, the Fund's other mission is to provide short-term assistance to its members, to assist them in dealing with temporary balance of payments difficulties. If we thought that a country had a chronic balance of payments disequilibrium which was not going to yield to sensible corrective action, we would not feel entitled under our policies to give it help. But again, as I said, you have two difficulties here. First, it is not easy to know when we are dealing with a chronic disequilibrium, and, second--and this is the hardest--it is not easy to know in advance whether a given set of corrective actions are going to work, or indeed--and this is even worse--whether there is going to be a serious effort in the event to carry out an agreed corrective program.

We can advance money to Brazil, let's say, on a program of action, and then find that in the event the Brazilian officials just don't carry it out. Well, they maybe try again. Again, in an international institution of this sort, we live in an imperfect world, and I'm afraid what we do is imperfect, partly because we are all part of that world.

The heart of the Fund's policies on the use of its resources gets at the question of unconditional-versus-conditional financial assistance. Indeed, this is the heart of the whole discussion of ways of improving the liquidity facilities of the world. In brief, we make available a portion of each country's quota to the country in any currency it needs on an unconditional basis. It could be a very bad country, doing a lot of wrong things, but we will give it some help, some defined amount of help automatically. But, as one progresses up in the quartiles, or as we call it, the tronches, of the country's quota, which under our ordinary practices are five--the first 25 percent ordinarily reflects their payment in gold plus four so-called credit quarters, or tronches--the Fund exacts more and more conditions of the country before it will give the country access to the upper ranges of the quota.

Now, that latter role of conditionality in the use of the Fund's resources puts the Fund, of course, in a potentially powerful position as a guider of actions of countries, because we have the power then to say yes to a country that we think is going to do something sensible and no to a country that is not going to do something sensible.

This has become conspicuous because, as countries now turn to great commercial banks in the United States and Europe to ask for short-term help, those banks, if they don't themselves like how things look in a country, have gotten into the habit of saying, "Where do you stand with the Monetary Fund? Have you got an arrangement with the Fund? Have you got a standby arrangement or can you get one? Have you got an agreed program of action to get yourselves out of this deficit that is causing your trouble?" If the country says no and has to say no, then they may find the doors closed to them in the commercial banking world of the great powers.

Now, this isn't a happy situation. It isn't one that the debtor country under those circumstances relishes. It's resented. The Fund is generally resented. Curiously enough, the Fund is resented from both the left and the right in the world. We find that there is a kind of unplanned and quite unholy alliance between the conservative right of the business world in these countries and the radical left, including the Communist left, neither one of whom want the Fund's policies to work. The radical or Communist left doesn't want it to work because chaos is the thing that they flourish on. It's extreme inflation, it's disorder in the currencies of the country. All of this is made to order for the Communists and for the extreme leftists, although, of course, once they get in power, as we all know, they have their own ideas as to how to deal with these disorders in the most brutal way.

The extreme right, on the other hand, that ought to know better, for other different reasons, is just as opposed on the whole to rigorous efforts to correct those factors which lead to extreme inflation and monetary disorder. Deflation or control of inflation is just never popular among bankers and business men. They don't like to admit that but they don't throw their support behind the effort of their own government to deal with these problems, and as a result we have found ourselves in the Fund thwarted from both extremes.

It's only the center, it's only, indeed, ofttimes, the central bank and treasury officials in the countries who speak our language and we speak theirs, and we struggle along trying to find some course of action which politically has a chance of success.

In view of the large resources that the Find has--and let me say that those resources amount to about $14 billion, a substantial part of which is not in usable form because it consists of currencies of LDC's that obviously you can't loan to other LDC's because this wouldn't make a whole lot of sense and would be like taking in each other's washing--our usable assets consist of our gold and of our holdings of the currencies of the 10 or 12 industrial or quasi-industrial countries in the world, including Canada and Japan and otherwise the U. S. and the Western European countries, those currencies which we hold in the form of non-interest-bearing notes which we can cash or turn into actual cash in those currencies and sell to the LDC's or anybody else, including the industrial countries, that is in need, plus our power to borrow, which is unlimited under our articles but which at the moment has been crystallized in the form of a so-called borrowing arrangement, by which 10 of the industrial countries have agreed to loan the Fund $6 billion in their currencies, broken up by 10 amounts, depending on the size of the country, on our demand, on the basis of some fairly complicated conditions. These three groups of assets do add up to something like $12 billion, and that is again a lot of money at any time, and it does mean that the Fund is the principal, reliable, secondary line of reserve available to member countries, the first line of reserve being the country's own gold and foreign-exchange holdings, plus, let's say, the easy private credit which some countries would have, such as the international swap arrangements that our own Treasury and Federal Reserve have worked out in the last two years.

I suppose one could say that with the emergence of those sorts of arrangements the Fund has in a sense become the third line of reserves, the country using its own gold and foreign-exchange holdings first, then maybe these easily available private or official sources of borrowed money, and then turning to the Fund. But most of our members don't have that second facility. It is only the larger industrial countries that can work out with each other these swap arrangements, so that most of the countries, like Australia, or New Zealand--to take an orderly one--or Latin American countries and Asiatic countries would regard the fund as their main, reliable, secondary line of reserve.

Therefore, the Fund bulks large in all the discussion of what to do to improve the International Monetary System. I might now briefly talk about that subject again which I mentioned earlier and what is in the press now being called the liquidity issue which bulked so large at the recent annual meeting of the Fund Board of Governors and is to be found discussed almost daily, as you know if you read the financial pages, by the leading financial journals--the Wall Street Journal or the Business Week or the London Economist, and the New York Times, and so on.

To put it in a few words, as far as the Fund is concerned there are some people--I suppose one would say most people, the most informed people--would agree that the Fund ought to continue evolving, to find more sensible ways of being helpful, of being a more useful apex of the International Monetary System. But there are other people who would argue that the Fund ought to be converted into, in effect, a super-central bank, and should be given more money and more power.

Well, when you talk about turning an international institution into an even more authoritarian institution than the Fund now is, and giving it therefore more power and more money, obviously you are dealing with the touchiest kind of possibility, one which, if I wanted to take what crystel ball I've got and look well down the road, might come some day but one which will, in my view, be a long time in coming.

The Fund, in my view, is not going to be converted into a super-central bank, nor is any other super-central bank going to be set up in the foreseeable future. But, having said that, it is quite clear that the Fund is going to evolve further and be given more powers and probably more money, and that there will not be any other international/institution set up, although there may be further evolution of regional institutions.

To turn briefly, then, for a few more words on the liquidity issue, the International Monetary System is now, as in the past, being tested again for the adequacy of its powers and its instruments for providing international liquidity. Now, international liquidity is an easily abused term. It does not, in the mind of the technician, properly include those normal, day-to-day, international, commercial facilities and banking facilities which finance from day to day world trade, world short-term capital movements, world movements of people, insurance transactions, and the like. It is true, of course, that the financial mechanism, particularly the great commercial banks of the world and the great investment banks in the world, which do provide these facilities, themselves are part of the total monetary structure. To some extent, vague in some countries, not so vague in others, they find--even if they are aware of it--that their capacity to carry out their activities depends upon the liquidity-creating powers of the system as a whole.

But liquidity, as we ought to be using the term, consists of that mass of facilities available to the monetary authorities of the world--the treasuries and the central banks--by which they are able to deal with balance of payments disequilibria and to be able themselves in the background or as an underlying matter to permit the financing of this growing mass of transactions.

Now, the John Maynard Keynes prototype for a world monetary system which would, in his view, have adequate powers to provide liquidity, was one in which the fund, at the apex, would in effect hold all international reserves, or most international reserves, received from the creditor countries, whoever the creditor countries were at a given time, an inflow of their net creditor positions, and would make them available to the debtor countries, whoever they were at a given time, to finance their net deficits.

The Keynes position is often misunderstood. I was just last night reading News Week which has this column by Henry Hazlitt--it's usually from my middle-of-the-road point of view a fantastic column, and I don't understand why News Week publishes it, but I always read it. Henry Hazlitt called for the abolition of what he likes to call the International Monetary Fund System. He has never come to the Fund to talk to us over these years. He had an appointment with me some years ago at his own instance and then cancelled it. He again says that Keynes is to blame for all this and that Keynes was in favor of total automaticity.

This isn't really true. We have again checked back to the Keynes prototype and to what he said and what he wrote into it, and strangely enough Keynes said very positively that the fund, as he saw it, should have the power to discipline countries and should have the power to insist that the countries change their exchange rates when that was the way to avoid continuing disequilibrium.

Now, I think this would disappoint Mr. Hazlitt, because this is, of course, what he wants countries to do, to change their exchange rates all the time, and then he also, in the last sentence of this article, gives one, final piece of advice--we must go back to the gold standard.

Well, this is a little pathetic, because the world isn't going to go back to anything, unfortunately. It may be that there were great golden things to do back somewhere, but the clock never gets turned back, as all of you know. Maybe some of you wish you could go back to the cavalry, which seemed to have been a very heroic and romantic thing, but I am sure none of you would really recommend that the thing to do strategically is to go back toquaint cavalry organizations. It's just about as sensible in my field, from my view, to say that what we should do is go back to the gold standard. And yet there are some very wise men who say we should. Jacques Rouette of France keeps telling DeGaulle that the one thing you've got to do is go back to a pure gold standard.

In any event, the Fund does, within certain limits, hit the Keynes model. We do, through our mechanism, take money from the creditor countries. We call on the creditor countries to provide their currencies, and we pay them out to debtor countries who need them currently. So the basic mechanism is that mechanism. And this basic mechanism, of course, is susceptible to continuous evolution. How much you pay out depends in part on how much you've got. We can always pay out more than we do. It depends also on what conditions you are going to set in order for a country to qualify for assistance.

The various proposals that are being currently discussed, for instance, Triffen's proposal, which is the most discussed, and Max Stamp's proposals in the United Kingom, and so on, from the academic side, or from the nonofficial side, would have as their aim greatly increasing the capacity of the Fund to push out liquidity as the Fund thought it was needed, even to take the initiative in pushing it out. In other words, Triffen would argue that, if there weren't enough debtor countries, or enough good debtor countries, who wanted enough liquidity to meet the needs, then the Fund, according to him, should take the initiative in finding ways to push out money, even by what you could call international open-market operations or international investment operations by the Fund and good creditors.

In this connection Triffen, like Keynes, would say--and I should say that in this respect Triffen is the 1962-63 version of the Keynes clearing plan of 1944-45--that bad debtors shouldn't get any help.

I would say next that Triffen and some people like him feel that the reserve currency institution has outlived its usefulness and that it should be gotten rid of by one or another kind of arrangement. His solution would be for countries to deposit virtually all of their reserve currencies in the Fund. The Fund then would carry the claim on the UK and the U.S., the big reserve currencies, and over a period of time the UK and the U. S. would be expected to redeem back in other currencies or gold that initial mass, and from there on there would be no reserve currencies. The Fund and its powers would provide reserves of the world other than the gold which countries, insofar as they still had some, would be able to go on using.

Now, I think I have said enough to show you that this is, in the eyes and the minds of some of the technicians, a subject that puts us away out in the frontier of the evolution of the world institutions. To get it down to a more practical range, I would say this: First, that most competent technicians and officials who are working in this field, both in the Fund and in the leading central banks and treasuries, agree that international liquidity, as I have defined it, is adequate at the present time. That is to say that the world is not being held back in its total economic development and in the growth of its total transactions each year by a lack of liquidity.

At the same time, all of us agree that the world could be held back by a lack of liquidity. In other words, there is no question that there is an organic relationship between world transactions and liquidity. To give you a crude example of that relationship, suppose the world went back to the pure gold standard. Suppose that the only reserves were gold and that the growth of liquidity, therefore, was entirely dependent on new world output that would go into reserves as against private hoards or jewelry. There would be a deflationary pressure at once in that kind of system.

Now, the Hazlitts and the Rouettes have a very easy solution. You raise the price of gold at that point to whatever point you need in order to have a mass of gold liquidity which is enough. In other words, you have a general depreciation of currencies, and then you go on from there.

I am going to show you that however you look at this problem you do get back to the question that there is an organic relationship between liquidity and world economic activity. But most of us feel that there is enough at present. We also agree that there might not be enough later, and that therefore we ought to study it.

There are now going on, as the result of general agreements reached at the recent annual meeting, two big studies of liquidity. The 10 industrial countries in the so-called general arrangement to borrow in the Fund, including the five largest of the six in the Common Market, plus Sweden, Japan, the United States, and Canada, are making a study through a group of deputies which in fact had their first meeting in Paris yesterday and will be meeting again on Friday, and then will meet again, I think, in December. We have an active observer there to link the study that they are making with the study that the Fund is going to make.

These studies will parallel and they will examine all kinds of possibilities, beginning with a difficult examination of the need for liquidity. There are people who don't think there is any need for it now, and they are very suspicious in thinking, in the creditor countries of the world, that, if they admit prematurely that there is a need for more liquidity, they will be the ones who will have to provide more liquidity. This gets you right back in this touchy problem of whether the good creditor, whose credit position is the result of his own virtue, must carry the bad debtors, or any debtors, and particularly the United States.

Now, there are various possibilities, and I haven't time to discuss them. I'll just mention a few of them. We might have quota increases in the Fund. We might have increased automaticity of IMF drawing rights. We might have an increase in what we call compensatory financing, to help LDC's to offset temporary declines in their export earnings. We might have an arrangements for deposits to be made in the Fund by countries, with the Fund having the power to use those deposits for certain purposes. We might have transferability of Fund certificates of indebtedness resulting from the Fund's borrowing. There are various kinds of things of this sort. There might be a further evolution of the swap arrangement between central banks that have rather dramatically increased and reached almost $2 billion in total in the last two years. There are all kinds of these possibilities which in the next 12 months will be subjected to very earnest study.

Thank you.

DR. BARRETT: De. Southard is ready for your questions, gentlemen.

QUESTION: Doctor, is Canada in a state of chronic disequilibrium in regard to her balance of payments? If so, is the International Monetary Fund doing anything to help her?

DR. SOUTHARD: I would say Canada is not in a state of chronic disequilibrium. This shows just how hard it is to set up a single test by which to test equilibrium which will work as a rule of thumb without the most careful examination of the facts. Now, it is true that over the period of, say, the last 10 years Canada has had a tremendous visible deficit, that is, a deficit on trade. Canada is importing a great deal more than she is exporting, of goods and goods-related services.

From that point of view one could say, "Well, it is obvious that there is tremendous chronic disequilibrium." But, of course, this was being offset by a very large, reliable, continuous inflow of capital, most of it from the United States, most of it going into Canadian industry for expansion of the Canadian economy, some of it going in in short-term form, into already existing securities.

Now, this was a perfectly normal thing. Canada was a very rapidly growing country with inadequate domestic savings, importing capital in a perfectly normal way. As long as that situation was stabilized and reliable, then by definition they were not in any disequilibrium. Indeed, much of the time you could say it was the other way around. They were beginning to be in a surplus position. Witness the fact that during the period when they had a fluctuating exchange rate the Canadian dollar stood at a premium with respect to the U. S. dollar year after year.

Now for a lot of reasons this has become more unstable. It has become more unstable because the Canadian officials themselves have become restive about it. They have thought that Canada is too much dependent on foreign capital, that this visible deficit is too big, that they are too vulnerable to the effects of a cutoff of the capital.

When the U. S. announced the equalization tax and made it apply to Canada in the first announcement, overnight Canada had the biggest foreign-exchange crisis for 48 hours that they had ever had in their history, because everyone knew that if this resulted in suddenly cutting off the net inflow of capital, then at worst they would be in a balance of payments crisis which, if it couldn't be alleviated, would mean that they would be on the edge of not what we could call a chronic disequilibriam but a disequilibrium which would be so acute that if they didn't do something about it in a hurry they would lose all of their reserve in a couple weeks' time.

That's one reason why they want to do something about it. Another reason is that they see the posture of the United States in the capital field and they have come to fear that we are not going to be willing to allow as large an annual inflow of capital into Canada as has been true in the past and that they ought to become less reliant on the United States capital market.

The only way they can become less reliant on the capital market is by increasing their net outflow of goods and services, or decreasing their net imports, and they are in the process of doing that. Some of the ways they are doing it the United States Government doesn't like very well, as you know. Indeed, behind the scenes there is a very acute disagreement. That disagreement really centers on the Canadians' concept of what they need to do to deal with the balance of payments situation, which in my view, I repeat, has not up to now been a chronic disequilibrium.

QUESTION: Doctor, you have indicated the impact of the Fund on exchange rates and par values. To what international agreements, pressures, or moral commitments would the United States be subject if they desired to devalue the dollar?

DR. SOUTHARD: Well, the United States can't change the par value of the dollar without the approval of the International Monetary Fund. If we did change it without the approval of the Monetary Fund we would be in violation of our obligation under the formal agreement that we have entered into. As far as I am aware, this is the only international sanction or obligation that the United States faces in this respect. If you put the question that way, it's the only one. We have given no cold guarantee commitments to anyone, anywhere, to the best of my knowledge. These swap arrangements are in terms of foreign currencies on our side. In other words, the Treasury enters into an arrangement to swap dollars for Swiss francs up to an X amount of dollars, if the Treasury wants some Swiss francs at a given time. It gets the Swiss francs and of course its obligation is to repay Swiss francs.

It isn't a guarantee, in other words. It's a foreign-currency obligation. We have entered into some of those. But that isn't what you are speaking to.

I don't know of any other sanction or obligation, except this one. Now, under U. S. law, of course, this is very complicated. The power of the Executive to devalue the dollar without the consent of Congress is probably nonexistent, with, I believe, one exception, but it's a powerful exception, in my view. The United States could stop selling gold without the approval of Congress. By the fact of not selling gold we could de facto devalue the dollar, without the approval of Congress.

In my own opinion, since this is, I am told, an off-the-record meeting, if any Secretary of the Treasury were ever to reach the point where he decided he had to devalue the dollar, that's the way he would do it. That's the only thing you can do on a Saturday afternoon, with not any knowledge in advance, without any consultation with the

Congress, but do it, and then see what happens next.

It's a curious thing. If he did that under the articles of agreement of the Fund, what would his position be, as the U. S. governor of the Fund? He would not be maintaining the par value of the dollar. He would not be maintaining the dollar between the one percent either side of par value. But there is a curious provision in the articles of agreement, put in to suit the United States. It says that a country which freely buys and sells gold need not maintain the buying and selling rates of its currency within the one percent range. The U. S. wrote a letter at once in 1946 and said, "We invoke that article."

Therefore, we have thrown on to the other countries the obligation to maintain the buying and selling rates for the dollar at parity in their markets. We don't do anything about it except to buy and sell gold. Once we stop freely selling gold we will then be obliged under the articles to maintain the dollar within the parity limits of one percent. If we didn't do that then we would be violating our obligations under the articles.

Is that all clear?

QUESTION: Dr. Southard, could you please discuss the Fund's success or lack of success in its international discipline in Latin American countries?

DR. SOUTHARD: How much time have I got? This is a very good question. It's one that we live with and try to answer all the time.

If I tried to give a one-or-two-sentence answer, I'd say that again, this being a very imperfect world, it's a mixture of success and failure.

We have had a very large number of so-called stabilization understandings with LDC's--Turkey, if you will, Iceland, taking the European area, and Finland. In Latin America we've had understandings with probably two-thirds of the countries, or maybe more than two-thirds, maybe nearly all of them except Venezuela, it seems to me--at one time or another every one except Venezuela. I may be wrong. In Asia, Indonesia and Ceylon. In Africa, Liberia is the most recent one, Morocco, Egypt, and South Africa. So, all around the world we've had a great number of these.

Now, in my opinion, some of them have been very good successes. The countries have done what they set out to do. Sometimes there has been a change in par value and sometimes not. It has meant budget restraint and it has meant credit restraint. Some of them have succeeded for a while and then they have gone into a binge of drunkenness again. Then they have come back and said, "Let's try it again, please." Ecuador did that. Ecuador had in our view a brilliant success. Then under this literal drunkard, as you know, it took them about nine months to undo everything they had done. Then they came back to us and said, "Could we try it again? Let's have a new arrangement." They have lived up very well to the new arrangement. It's remarkable how these things will shift.

We've had very bad failures--Brazil, and probably Indonesia. The UAR is very chancy. I wouldn't give us very good marks on our repeated efforts there. Ceylon hasn't amounted to much. Astralia has worked excellently. South Africa worked all right, very well. In Liberia we are right in the middle of a humble little effort. In Bolivia there was very little to work with, and it has been remarkable how well it has worked out.

So it's a mixture. You take two steps forward and you take one back. But the one thing we are convinced of is that we can't afford to say, "Well, to hell with you. Don't bother us. You didn't do well, and we're through." We've got to try over and over again and lick our wounds and say, "Well, if you really come back in good faith, we'll send some more people down to work with you, and we'll see if we can work out another arrangement."

We are convinced that this pays dividends, but it's an awful hard task, and a very thankless one most of the time.

QUESTION: Doctor Southard, previous speakers have given us the national viewpoint on this, and we now have the international side. What are the views and reactions to the United States and our program of now offering long-term bonds, payable in the foreign country's currency, in exchange for dollars? And, second, on a supposed side, what strains would you see develop if the United States would revise the law and drastically reduce the internal gold reserve requirement?

DR. SOUTHARD: Well, on the first one, I don't understand your words, "long-term." The longest I have heard of is the so-called Roosa bonds, and I understand they are 18 months. If you are within this range, as I said earlier in a sentence or two, Bob Roosa--who has recently talked to you, I think--saw this clearly and wisely. He wanted to build up a new, previously nonexistent line of reserves for the United States in currencies other than the IMF, so he began by very short swap arrangements between treasuries or between central banks, in many instances, which on the U. S. side really, of course, meant that the New York Fed would be acting as Treasury agent, although in some of the other countries the central banks would be acting on their own.

He has then sought to extend this to the intermediate-term position. Let's not even call it an intermediate term. It's something like 18 months. It's a little hard to evaluate some of that, because this is to some extent linked up with the very untidy set of concepts of our balance of payments of what items we regard as short liabilities, which happen to be included in figuring out our overall deficit, and what ones we regard as being above the line, so to speak, of just longer-term U. S. borrowings which aren't. In other words, if an American company borrows 30 days abroad, this is a short-term liability on our side. If an American company invests abroad long term, then in an intermediate period you get an outflow of funds which add to the deficit, but at least you have a different kind of operation.

Now, on the official side, the Treasury would construe these Roosa bonds as not being a measure of increase in the U. S. official short liabilities, but rather an increase above the line in longer-term U. S. debt. This, from a presentational point of view, has some usefulness, but, of course, like most presentational matters, it has no real economic substance to it, because these 18-month issues are all convertible 90-day issues on demand and to cash on two days' notice.

So that this is very shadowy and nebulous kind of thing that Roosa, I think, is working with here. But, broadly, I'd say that we now clearly have this new echelon put in between a country's own reserves and its drawing right from the Fund, of these official swap arrangements. It doesn't really matter to me, as a technician, whether they are central bank 20-day swaps or whether they are Roosa bond 18-month arrangements with a two-day conversion right into cash. They're all the same.

I don't really believe that this is susceptible of much further extension. I don't know what Mr. Roosa said, but I believe this is the official U. S. view behind the scenes also. This $2 billion figure, or roughly that, is about what they think they can get. The foreign countries who are partners are fairly restive about this. They're not going to take on these commitments to loan the U. S. Treasury on short notice beyond limit, just as they aren't going to agree to any corresponding quick obligation for the IMF. It gets them back into the same problem.

On the other question, well, I'm an old advocate of getting rid of this gold reserve requirement. I recommended this strongly to Secretary Anderson when I was his adviser in the Republican period. There is no use in it and no role at all in a modern monetary system. Now, from the standpoint of the gold-standard theorist or the person of more old fashion or a conservative bent, this is heresy. But our gold really has only one usefulness and this is to defend the international value of the dollar. We shouldn't have it tied up for a so-called domestic reserve requirement which doesn't help anybody anywhere under any circumstance in the United States.

We are the only big power that does it. We loaded ourselves, because we didn't take action in time of strength, when we had a big margin of safety, with a legal limit which is a danger line which everybody is watching all over the world. We have subjected ourselves to the great danger of a run on the dollar at some point, some interminable point, because if foreign holders of dollar liabilities decide that we are getting too close to the line they are going to get their gold while they can.

I think this is a major flaw in our old monetary equipment which ought to have been corrected, but, unfortunately, we are dealing here with symbolisms, with superstitions, with passionate feelings, and it just doesn't seem to be possible to get rid of them.

QUESTION: Doctor, is there any discernible relationship between our balance of payments deficit and our rate of unemployment and our rate of economic growth?

DR. SOUTHARD: Yes, there is a relationship, I guess, but it's a very complex one. I'm not sure that I can trace it. I would say that up to the present time our deficit has not had anything to do with our unemployment figure because we have really not followed, in my view, any domestic financial policies which have had any measurable restraining effect on our domestic financial operations which could have kept down growth and therefore kept unemployment up.

We have done something in the short-rate, interest-rate field with an eye to the balance of payments. We have kept short-term rates up, but short-term rates have relatively little to do with growth until they get translated into longer-term rates, and the long-term rates have not gone up, it seems to me, any more--let's have it agree with the Federal Reserve view--than one would have expected from an economy which has been expanding pretty rapidly in the last two years.

Now, if we were to decide not only that the balance of payments deficit had to be reduced but that the only way to reduce it was to take more drastic action on the monetary side, then we could, by letting the balance of payments guide our policy or rather be the determining consideration in our policy, impose a degree of credit stringency on the economy for the sake of sending interest rates up and discouraging the outflow of funds which would, at the same time, have a restraining effect, or could have a restraining effect, on the domestic economy bwyond what the needs of the domestic economy, looked at alone, would call for. In that sense you would, at least temporarily, have link between our growth rate, our unemployment rate, and the balance of payments.

To my view that has not yet happened. I wouldn't say that it couldn't happen, because at some point we could be faced with an acute set of choices of what to do about the dollar. If we ruled out devaluation, which I think we would have to do, if we ruled out restrictions, and I think personally we would have to, then relative deflation at home might be in the cards.

QUESTION: Doctor, what is the relationship today of Cuba with the International Monetary Fund?

DR. SOUTHARD: Well, it's practically silent, I should say. We advanced $25 million to the Batista government on a six-months basis. We had made two six-months advances. They repaid one and then withdrew $25 million again--half their quota--in the period of the Castro effort in the Sierras. We did it with our eyes open. I don't think we had any good crystal ball. We didn't know who was going to win. They deserved assistance and we gave it to them. Then when Castro got in power, during that period of some moderate honeymoon when he did have some moderate advisers around him, including Philippe Di Passos, who was an old friend of ours and went back in as the head of the central bank, they asked us to extend this from a six months' obligation to one of our standard 3-to-5-year obligations, and we did.

They paid the charges regularly in gold--it had to be gold. Then they did introduce some exchange controls without our approval and without any effective consultation, although we did talk to them about it. Then, when the three-year period was up and they ought to begin moving into a schedule of repayments of the principal, they asked us for a schedule of repayments which would have extended beyond five years, running into 6½ years, I think, total. We said no, that we weren't in the habit of extending this beyond that time, and we asked them to make an effort to meet their commitment to us. We got no answer.

Then, in the meantime, on September 12, this became a five-year obligation. In addition there are three or four other violations of the articles--failure to provide us with information, failure to get our approval for exchange restrictions, failure now to repay, and one other--I've forgotten what it is.

So--this is off the record--we have told them formally--sent them a formal memorandum which had been tabled in front of the Fund Board--calling their attention to these various violations of their obligation, and asked for their comments before we considered what else to do. We have had no reply.

What do you do next? I don't know. There are certain sanctions, including kicking them out, as we did Czechoslovakia under rather comparable circumstances. When that was done I was the protagonist, and I had to carry that Czechoslovak exercise. This was a time when the U. S. voice was a loud voice and carried great weight and we could drive it through. Today it is not clear to me that the U. S. Executive Director could drive through an expulsion of Cuba from the Fund--not now, I mean. There would have to be more time and more Cuban recalcitrance. If the

Cubans chose to come before the Fund Board and plead their case with restraint, as the Czechs did, with great skill and restraint--not as vituperative Communists but as skillful Communists--then it is hard to tell what the bulk opinion would be in an international institution. Of course, as we know, the Cubans could make out a case that the U. S. was making it impossible for them to do this, that, and the other thing, and so on.

If, on the other hand, they chose the route of vituperation, or ignored us, then I would think that step by step the Fund Board could find itself pushed into sanctions. But this is very much in the future.

QUESTION: Sir, you referred to the rather illogical criticisms of Henry Hazlitt and his current views in his article. Do you feel that his criticism may be explained by his personal feelings toward Harry Dexter White?

DR. SOUTHARD: Well, there is a little bit of this, if one caught it. In this weeks article he chooses to bring that up. It's a fact. I worked with Harry White. In fact, I was the third human being to see the original White plan before I went into the Navy at the beginning, after Pearl Harbor. It's a fact that White was the architect and that the present Fund is White designed and not Keynes designed. White was a Communist agent probably, in my view. I had to live through this period of looking at the evidence.

Then there is a strange thing, one of those inexplicable conflicts in a man's mind--he turned out a very conservative articles of agreement for an international monetary institution.

I can't answer your question beyond that. It may be that this is colored, but I think that Hazlitt probably disliked Keynes more than he dislikes White. And Keynes was an honorable man.

DR. BARRETT: Gentlemen, I fear we must stop at this point. Dr. Southard, we are indebted to you. Thank you very much.