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THE ROLE OF THE CENTRAL BANKER TODAY

Lecture delivered by
Mr. Louis Rasminsky

November 9th 1966
Altieri Palace - Rome

THE PER JACOBSSON FOUNDATION

With introduction
and commentaries
by

Dr. Stefano Siglienti
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LOUIS RASMINSKY, *Governor,*

Bank of Canada

With Introductory Remarks and Commentaries by

DR. STEFANO SIGLIENTI   DR. DONATO MENICHELLA

MR. MARCUS WALLENBERG   DR. FRANZ ASCHINGER

November 9th, 1966

Associazione Bancaria Italiana

Altieri Palace, Rome, Italy

under the sponsorship of

THE PER JACOBSSON FOUNDATION

FOREWORD

The Per Jacobsson Foundation was established in 1964 for the purpose of carrying forward the unique contributions which Per Jacobsson had made in the field of international monetary cooperation. Following his death in May, 1963, a group of his friends, led by a number of distinguished sponsors, joined in creating and financing this Foundation to sponsor lectures, seminars, and publications in this field.

The first lectures were given in Basle in 1964 on the subject "Economic Growth and Monetary Stability." Mr. Maurice Frère of Belgium and Mr. Rodrigo Gómez of Mexico were the speakers.

In Washington, D.C., in 1965, Dr. C. D. Deshmukh of India and Mr. Robert V. Roosa of the United States spoke on the subject of "The Balance Between Monetary Policy and Other Instruments of Economic Policy in a Modern Society."

This pamphlet contains the text of papers given in Rome on November 9, 1966. The principal speaker was Mr. Louis Rasminsky of Canada, on the subject "The Role of the Central Banker Today." Opening statements were made by Dr. Stefano Siglienti, President of the Associazione Bancaria Italiana, and by Dr. Donato Menichella, Honorary Governor of the Banca d'Italia. Mr. Marcus Wallenberg, Vice-Chairman of the Board of the Stockholms Enskilda Bank, and Dr. Franz Aschinger, Financial and Economic Editor of the *Neue Zürcher Zeitung,* provided commentaries on the main topic.

Through the courtesy and hospitality of the Associazione Bancaria Italiana, the meeting was held in their headquarters at the Altieri Palace, Piazza del Gesù 49, Rome. The Associazione is publishing in Italian the texts of the papers given by Mr. Rasminsky and Dr. Menichella.

Requests for extra copies of the 1966 Proceedings in English, French, and Spanish may be addressed to:

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WELCOMING ADDRESS

by

STEFANO SIGLIENTI
President, Associazione Bancaria Italiana

YOUR EXCELLENCIES, Ladies, and Gentlemen: It is my good fortune, as President of the Italian Bankers' Association, to have the privilege of welcoming all our guests from several countries who join us here today to honour the memory of Per Jacobsson.

To the President of the Foundation, Ambassador Burgess, I would like to express the thanks of all of us Italians, and especially of the Bankers' Association, for conferring upon Italy the high honour of being hosts to the annual conference of the Foundation and for selecting these headquarters of the Italian banking system as the site for this occasion.

The Italian Bankers' Association on its side has chosen for today's meeting this hall where we still can hear the echo of the profound words of Per Jacobsson who, in this very hall, on 27th September 1961, gave us his thoughts on the monetary problems of that time in a memorable lecture.

I would like to consider our meeting today above all as a right and proper exchange for the warm compliment that Per Jacobsson paid our country when, in the introduction of his lecture, he said: "I love the Italians and I should add that I have always been able to cooperate very easily with the representatives of this country, from whom I have learnt a lot."

He had a real friendship for our country. And he proved that by the eagerness with which, ten years previously, he accepted the invitation of our Association to take part in the International Credit Conference in Rome. At that time he was here as economic adviser of the

Bank for International Settlements. I still remember that, in his wide-ranging speech on banking liquidity, Per Jacobsson saw the initiative of the International Credit Conference as a "forum" (in the special Roman meaning of the word) where a full exchange of ideas amongst experts from over fifty countries had largely contributed towards the clarification of problems which at that time called for directives, choices, and measures.

It was at that time that he pulled us back to reality when he said that "the world we live in is a difficult one."

Fifteen years have gone by since then, during which it has been shown how profoundly true that statement is. Coming from a man like Per Jacobsson, who was always driven on by the urge for action, it was not the result of a pessimistic outlook on the world. Rather it was that he felt deeply the responsibility for the important missions that were entrusted to him because of his qualifications and his sense of dedication.

The intense interest which he took in his work is not just a matter of history for us. It is a living reality since he has consolidated an institution which is proving to be of fundamental importance.

If, in fact, the needs of today and those of the immediate future clearly demonstrate how the *only way towards progress is an increasingly closer cooperation between countries at different levels of economic development,* then the International Monetary Fund has proved itself as an essential instrument for practical cooperative action since it helps the single countries face their temporary external imbalances.

I think that the majority of you here are with me when I say that from Per Jacobsson's thinking and from our own spontaneous conviction two key concepts come to us:

First, there is the concept that any instrument which enters into the wide and complex, though limited, field of monetary policy must always be considered within the broader compass of general economic policy. Second, the more that financial technique extends itself over the more open ground of economics, the more it is divorced from barren and prefixed forms, the more it has need of the practical sense of top managers, the more it relies upon the personal ability of the men who guide it, and the more it requires understanding, tact, and a balanced judgement. In a word the *technique is humanized* as the tasks to be undertaken and the situations to be overcome increase in difficulty.

Governor Rasminsky, whom we are honoured to have here in Rome, will, I think, confirm this when he deals with the subject after Dr. Menichella's introduction.

It is an extremely attractive subject for us bankers since, if the work of central bank is primarily addressed to us, we also feel that we are eager and active cooperators in continuously doing something that, in good or bad times, more and more consolidates the unity of the banking system, which is a basic essential of national economic life.

In the difficult world in which we live we are made constantly more aware of the need to meet growing difficulties, not only with the normal techniques, but also to bring into play the whole of a man's personality, thus turning professional skill into an art.

Per Jacobsson was one of those exceptional men whose mission did not end with his life on this earth. This is evident here today, as assembled in his name to pay homage to his memory we find a group of prominent men, endowed with wide technical ability and long experience upon whom can well be placed the hopes of all for confronting the challenges of the world of to-morrow.

OPENING REMARKS

by

W. RANDOLPH BURGESS

President, The Per Jacobsson Foundation

MR. PRESIDENT, your Excellencies, Ladies, and Gentlemen: It is indeed an inspiration to see this group of people gathered together to pay tribute to Per Jacobsson and to his ideas, and to evidence interest in the continuation of the important principles for which Per Jacobsson stood. I welcome particularly the members of Per Jacobsson's family who are here. We would like to tell you, Mr. President, of our gratefulness to the Italian Bankers' Association for inviting us to this beautiful palace, and for your very wise words, which recognize so well what Per Jacobsson has meant in the world of finance.

We are all conscious of the fact that we come here at a time when this country is going through a very difficult period because of the floods. We of The Per Jacobsson Foundation, who have come to you as guests today, believe we should show some appreciation of that situation; accordingly, we are making a small contribution to the Italian group which has been set up to help deal with it.

Mr. President, it is particularly appropriate that we should meet here in the Altieri Palace, because that family was one with great financial interests — including the handling of financial affairs for the church — so that we feel at home here. But even more appropriate is the Italian background; there is no country in the world that has given such a demonstration of sound central banking in the past twenty years as this country, with just three Governors in the central bank over the whole twenty-year period. I do not need to name them to you, because you know who they are, and two of them are here today.

We are very fortunate in being here, and we are very fortunate in the program, to have Governor Rasminsky of the Bank of Canada, with his long experience in various phases of central banking and in the International Monetary Fund, and particularly to have persuaded Dr. Donato Menichella to come here to introduce Mr. Rasminsky. So, it gives me enormous pleasure now to introduce Dr. Donato Menichella, for years the head of the Bank of Italy.

INTRODUCTORY REMARKS

Per Jacobsson and Monetary Developments in Italy—1946-1947

by

DONATO MENICHELLA

Honorary Governor, Banca d'Italia

MR. CHAIRMAN, Ladies, and Gentlemen: There is certainly no need for an introduction to today's lecture, which is in the experienced and capable hands of Dr. Louis Rasminsky, Governor of the Bank of Canada.

His subject, the functions of central bankers today, is a well-chosen one, there being, indeed, a generally-felt need at the present time for a deeper knowledge and more precise definition of these functions. For both governments and the man-in-the-street are firmly convinced that sound monetary management is a prerequisite for progress by individual countries and by a properly functioning international community.

I should, nevertheless, like to take advantage of the Chairman's kindness in inviting me to speak today — as the Foundation is meeting in Rome for the first time — and pay tribute to the memory of Per Jacobsson, who loved Rome greatly and who concerned himself throughout his life with the central banks' problems.

More particularly I should like to recall, having witnessed it myself, the very keen interest he took in Italian affairs and the marks of friendship and sympathy he gave our central bank in the early post-war years, when we had to tackle the problems of fighting the severe inflation that was playing havoc with the process of reconstruction to which we were devoting so much effort.

Of course the monetary problems of today about which Dr. Rasminsky is going to talk to us are much more complex than those which we Italians had to face in 1946-47. In solving today's problems there is little that can be learnt, in the technical sense, from our experience of that time, chiefly because our difficulties then were for the most part a legacy of the war, and the economic climate was deeply perturbed by the great reduction in international trade and even by the appearance of real shortages.

However, it seems to me that there is, nevertheless, some link between our experience and the monetary problems of the world today. Our return to monetary equilibrium after an inflation which, as Per Jacobsson was later to write "had become an unmitigated evil," was, in fact, predominantly due — and this, too, he solemnly affirmed — to the moral qualities of resolution, courage, and patriotism of the man who led the battle, namely Luigi Einaudi. I shall later revert to this point. Now, these qualities are no less necessary today, and they will be no less necessary tomorrow, in those responsible for a country's monetary affairs, however complex and up-to-date the instruments at their disposal and however great the variety of measures which they can take either singly or together with fiscal or other measures. I am convinced, for this reason, that the link between our experiences twenty years ago and the problems facing the central banks today is sufficiently strong for a description of that experience — which I should like to recall in memory of Per Jacobsson — to be of some value for an understanding of the subject matter of our main lecture.

As I have already observed, Per Jacobsson's interest in Italian affairs in 1946-47 was very great. He stood by us with advice and encouragement and was ready to vouch for the successful outcome of our attempts to re-establish monetary stability. He spoke in our support to the many prominent financial personalities on both sides of the Atlantic whom he met in his capacity as Economic Adviser and Head of the Monetary and Economic Department of the Bank for International Settlements, and thus his attitude did much to secure for us the understanding and confidence of the various international credit institutions with which we subsequently had important and cordial dealings.

The experience of Italy made a particularly great impression on Per Jacobsson's mind. He often referred to it, in the writings and speeches [1] in which he constantly extolled the benefits of stable money.

Wishing to gain first-hand knowledge of our situation and problems, Per Jacobsson made a stay in Rome in January 1947 and, during the following months, kept in close contact with the Bank of Italy's Research Department, of which he thereafter remained a sincere admirer

[1] See the two collected volumes, *Some Monetary Problems — International and National,* edited by Erin E. Jucker-Fleetwood, Basle Centre for Economic and Financial Research, Basle, 1958, and *International Monetary Problems 1957-1963, Selected Speeches of Per Jacobsson,* International Monetary Fund, Washington, D.C., 1964.

and friend. He paid another visit of some length to Italy in 1949, in order to study our whole process of reconstruction in greater detail.

It has been said of him that for every ounce of knowledge which he imbibed he gave out two — and there is not one of us who had the good fortune to encounter him as a young man and in the prime of his life who would not subscribe to this epigrammatic judgment of his character and work. Imagine, then, what benefit we derived on both occasions from the intensive relations he maintained with us.

Per Jacobsson was well prepared for the economic and monetary problems of the post-war years.

His views and recommendations had already been placed on record in the comprehensive discussion of these problems that was published in the 14th Annual Report of the Bank for International Settlements towards the end of 1944, when the hostilities still kept him, as it were, tethered to the starting-post.

When he then arrived in Rome to study our situation, it was soon after the publication of a long report, which he had written in May 1946, on the guiding lines of a monetary policy aimed at injecting confidence and vigour into the post-war world.

This report had been written for the Monetary and Economic Committee of the International Chamber of Commerce and, as he was to reveal twelve years later, had been prepared by him "together with Burgess," who was Chairman of the Committee.

Perhaps this common paternity was one of the reasons why the sponsors of our Foundation unanimously decided to ask Mr. Randolph Burgess to become its first Chairman — in homage to a man whose books and teachings, and whose work at the Federal Reserve Bank of New York and with some of the major American financial institutions, made him a reliable guide for all those whose duties lay in the conduct of monetary affairs.

In his report and in the studies which preceded it Per Jacobsson took a firm stand against those who feared that there would be a post-war depression. In his view the danger, rather, was that prices would rise steeply as a result of a run on consumer goods, which continued to be in short supply after the war, whereas the public had been left with a large volume of liquidity available.

In short, it was inflation which the world needed to prepare itself to resist with the utmost vigour. Recalling that generals have often been blamed for planning their defences as if they had to fight the preceding war all over again, Per Jacobsson threw the full weight of his prestige into warning governments not to allow their fear of a repetition of the unfortunate events of 1920-22, or even, in many cases, of the disasters of 1930-33, to drive them into pursuing expansionary monetary policies, to which they might also be prompted by the legitimate desire to maintain a pattern of low interest rates.

In Italy Per Jacobsson certainly did not have much trouble in discovering that the enemy he feared, namely inflation, was already master in the economic field.

The war had reduced the value of the lira to no more than four centesimi, since wholesale prices were 25 times as high at the end of the war as they had been before it. Then, after a year of monetary calm, another serious bout of inflation had begun in the second half of 1946.

This new inflation had been preceded by a boom in equity prices and in foreign exchange quotations. It now coincided with a recovery of production — which, however, although supported by UNRRA aid, ran up against many difficulties and critical shortages, such as those of coal, electric power, and transport.

The upswing was strengthened by keen foreign demand for our products, especially textiles, and towards the end of the year it led to an appreciable rise in wage rates, so much so that the resultant increase in domestic demand for consumer goods far exceeded their supply.

Thus, during the fifteen months covered by the new inflationary process, the wholesale price average climbed from 25 times the pre-war level to 60 times and beyond. This more than halved the already diminished value of the post-war lira. Unfortunately, the biggest rises occurred in food prices on the free market and the black market, and yet everyone in one way or another had to turn to these, since the rations obtainable with coupons were so small.

To make matters worse, the price rise soon began to feed on itself, for the expectation of further rises led to large-scale hoarding and stock-building on the part of producers, and the trade, not to speak of the population itself, which, while demanding very severe penalties for the others, was itself doing all it could, even when means were limited, to stock up food and clothing. Naturally, there was a stampede into the classical refuge of gold and jewellery, and the flight of capital gathered impetus from day to day. The 125 million dollars or so which the export recovery had allowed us to acquire during the second half of 1946 were rapidly draining away and, by September 1947, just before measures were taken to put an end to inflation, they had dwindled to a mere 9 million dollars. All we had left was 23 million pounds sterling, but there was not much that could be done with a currency that had been declared inconvertible a month earlier.

No wonder then that many Italian minds were occasionally haunted at that time by memories of the collapse of the German mark after the first world war and of the similar fate which had recently befallen the Hungarian pengö and the Greek drachma.

It is not my business today to list the explanations which were then current among the public for the events which I have briefly described. All, or nearly all, of them went no further than the surface and merely picked out the most eye-catching aspects as a stick with which to beat the government. The authorities were accused of being incapable of enforcing the price controls that existed for certain foods, and unwilling to extend them, and they were blamed for not levying heavy taxes on the profits of speculators and the *nouveaux riches.*

At a higher level, current developments fed the eternal debate between those that were for a free economy and those that supported planning, and they added fuel to political conflicts already raging for other reasons; as a result, there were radical changes in the party-political composition of the government coalition.

So expert and detached an observer as Per Jacobsson was not, of course, to be taken in by the popular explanations. Instead, he looked more and more deeply into our reconstruction process and into the real difficulties which stood in the way of rapid progress in agriculture and industry. Above all, he concentrated on our monetary affairs during the war and the two years or so afterward. His conclusion was that, apart from specific reasons for certain individual products, the basic cause of the rapid rise in Italian prices was the excessive liquidity remaining after the war — just as he had, in general terms, predicted.

Further liquidity had then been added to the market, notably by the financing of wheat stockpiles by the banking system, for the funds used derived, in the last resort, from the central bank.

Thus, Italy found itself in the position of the man who had a coat that was too large for him — a graphic metaphor that Per Jacobsson was fond of using. The man could do a number of things: he could leave the coat as it was and not wear it until he had grown into it, or he could cut it down to size, or he could just make some tucks in it for the time being. Per Jacobsson used to say that what his man had done in Italy was to let the coat out so that it was bigger still.

To cut the coat down, that is, to withdraw enough of the old and new liquidity from the market to forestall or at least counteract with some measure of effectiveness any further rises in prices, the central bank needed to have suitable instruments at its disposal. But it had none at that time, mainly because excess liquidity had broken the central bank's link with the banking system, and appreciable results could obviously not be expected in the given circumstances from the only remaining instrument, which was manipulation of the discount rate.

Thus, credit expanded extremely sharply and this became the principal channel through which liquidity, with a multiplier effect, reached productive enterprises and trading firms, while basic wage increases and the sliding cost-of-living bonus which had been introduced at the close of 1945 became the main channels through which liquidity flowed to households.

Having pronounced his correct diagnosis, Per Jacobsson was glad to see that it coincided with that of the Italian monetary authorities, which for some time had been taking action in two directions, one external and the other internal.

On the one hand, the authorities were making every effort to secure for our country foreign credits so as to be able to import more than could be paid for out of the aid actually received; and on the other hand they were taking steps to reduce the excess money supply.

Along the second line of attack, which was more strictly monetary, Luigi Einaudi, the Governor of the Bank of Italy, whom Per Jacobsson had known since 1928 and had met on several occasions, had been an ardent advocate of two large medium-term and long-term public loans. These had been floated in 1945 and late in 1946, and Einaudi had effectively contributed to their success. He had also called for moderation in government expenditure and had openly opposed the political price of bread readopted in 1946, a year after it had been courageously abolished. He had also unwearyingly been exhorting the banks to prudence and moderation, but when, in February 1947, soon after the closure of subscription lists for the second loan, bank deposits and current accounts once more started expanding, he did not hesitate to propose to the Government that the credit expansion should be checked by an appropriate and flexible system of compulsory reserves. This was to replace the existing system, which was not being actually applied and indeed could not be applied because it had been robbed of its rational basis by the devaluation of money.

Per Jacobsson was kept informed of the accurate studies on the basis of which Einaudi proposed to the Government that the new system of compulsory reserves should be adopted. Such studies were carried out by the Bank of Italy's Research Department and its able head, Dr. Baffi, a man loyally devoted to Einaudi and whom the latter rightly esteemed.

However, Per Jacobsson held, as we did, the view that the problem was not only one of selecting the measures to be taken. It was also necessary to get ready for overcoming the serious difficulties which would arise during their implementation. Concerning which, he liked to quote Napoleon's dictum that economic strategy was a simple art, in which the one thing that mattered was its execution; he drew from it the conclusion that what was needed for the success of a stabilisation programme was, above all, "conviction, character, and courage." But he knew that it was Italy's good fortune to have in Luigi Einaudi a man who, everyone agreed, combined in an outstanding way precisely these qualities with those of a first-rate economist and a faithful public servant, and from this knowledge derived the certainty that the battle would be won.

His confidence was strengthened when, at the end of May 1947, Einaudi joined the Government as Deputy Prime Minister and Minister of the Budget, while his distinguished friend, Gustavo del Vecchio, was appointed Minister for the Treasury. Herein lay a guarantee that the legislature would approve the bill that allowed the new monetary instrument to be used, and a guarantee also that, once the stabilisation programme had been launched, there would be no second thoughts or postponements — in short, no weaknesses that might raise doubts as to the success of the programme and, for that very reason, might obstruct it or delay its implementation.

Einaudi fought the battle with exemplary calm and truly democratic methods.

He fought it at the political level in the Constituent Assembly, then acting as Parliament, against men and parties speaking for those who, after the new system of compulsory reserves had been finally introduced in August of that dramatic year 1947, no longer found the banks easily complying with their demands for larger credits and who accused the Government and the Bank of Italy of having imposed severe credit restrictions.

He fought the battle mainly by trying to get public opinion on his side. For more than thirty years he had maintained constant contact with it through the columns of the most authoritative and widely-read Italian newspaper. He had commented, explained, praised or condemned the economic conduct of successive governments. Now he realised that it was necessary for him to re-establish that contact, in order to strengthen the political basis for his action. He began to write again in the same paper articles of the strictest logic, yet within everyone's reach because of their simple and natural style. In these articles he justified the policy of checking an excessive credit expansion by means of the reserve requirements.

He explained that this was being done in the interest of depositors, the banks themselves, and those social groups which inflation was gradually reducing to poverty.

He showed how fast credit had expanded: the ratio of business loans to total deposits and current accounts had in fact risen from 42 per cent on 31st May 1946, at the beginning of the wave of inflation, to 72 per cent at the end of July 1947.

Einaudi expressed his conviction that at this high level many banks would, of their own accord, have applied the brake which the new regulations were designed to impose, but he added that the latter were nevertheless required in order to ensure that no bank, even if it were less than prudent, got into difficulties, for in so sensitive a market as the credit market this might have had fatal consequences. And he went on to recall, in this respect, how going too far beyond the bounds of safety had led one of the big Italian banks to bankruptcy in 1921, thus throwing the whole nation into a turmoil and bringing despair to many families. He declared that he was firmly determined to prevent a repetition of such an event.

He explained that, as matters then stood, the new reserve requirements would tie up only 15 per cent of deposits, and that, even though the ratio might rise to 25 per cent as deposits grew, the banks would still be able to extend ample credit to firms, and certainly much more than was either permitted or actually granted in better organised countries. He added that in such countries the banks usually held a sizable portfolio of government bonds and other Treasury debt certificates which could easily be mobilised if necessary. As this was not done in Italy, the economic sector that had recourse to bank credit had no grounds for complaint.

And he had to fight, finally, against the many who not only condemned the restrictions placed upon the undue expansion of credit, but, repeating the tragic error made in Germany in 1923, were convinced that what was needed was a substantial increase in the money supply, since this was only thirty times as great as before the war while prices were sixty times as high.

He published all this but kept to himself his anxiety at the knowledge that the dollar reserves were exhausted just when they were most needed, not least because the wheat stockpiled that year was almost used up only three months after the harvest, which had been a very poor one.

But, as Per Jacobsson had said, courage was needed to bring a stabilisation programme safely into port. And courage shone forth when Einaudi, in the midst of the polemics unleashed by the new provisions, resolutely declared that he would not hesitate to raise the reserve ratio and raise it sharply, if the new demand for credit were, for example, aimed at hoarding, or building up stocks of goods. In the solemn surroundings of the Constituent Assembly, Einaudi explained, making his meaning quite plain, that hoarding included land, houses, jewellery, gold, foreign currency, and stocks and shares, which many firms had been buying as a hedge against further price rises, utilising for the purpose bank credits which they had requested for needs ostensibly connected with production and trade.

What happened next was that, after the first few refusals by the banks, everyone, for fear of being too late, rushed to apply for new credits far in excess of actual needs; as a result, the banks turned down applications more and more frequently. This made it easy to talk of pig-headed credit restrictions.

And then the stocks of goods began to be disposed of, even the stocks of those who, like many farmers, had not taken up bank credit, or at least not on a large scale, but who feared that in the new situation they might not be able to get credit if they needed it.

The distinct — and not merely temporary — fall in several key prices finally brought about a sudden change in public attitudes; the buying spree slowed down noticeably and savings again began to be made in monetary form.

As Per Jacobsson was to write later, it was a violent shock; but, as he added, a shock is generally necessary when things have gone so far — as they had done in Italy — that confidence in the currency has been shaken.

Victory had been achieved. In commenting upon it, Per Jacobsson paid tribute to the Italian people, who, by electing Einaudi President of the Republic, as they did a few months after the inflation had been checked, were paying him their debt of gratitude.

The danger was over, but just how great it had been was not fully clear until later.

The Government had indeed made every effort to contain the rise in public expenditure. But commitments assumed prior to the introduction of the new reserve requirements, together with those which had still to be assumed in order to go ahead with reconstruction and to satisfy the many social needs, far exceeded tax revenue. Although the latter increased considerably, inevitably it could not grow fast enough to keep step with the rapid rise in money incomes due to inflation.

Thus the Treasury's cash deficit for the fiscal year 1947-48, which had only just begun when inflation came to a halt, was inordinately high, exceeding 450,000 million lire. The following year it reached the same order of magnitude. Hence it is easy to imagine what would have been the effect of these enormous injections of new money on a market still a prey to the inflationary fever.

But, once the fever was over, a substantial proportion of the new bank-notes returned to the Exchequer as a result of large-scale subscriptions to Treasury bills and a sharp expansion of post office deposits. Those that did not return did not exercise any upward pressure on prices, because they were used to meet the legitimate needs for more money which arise when trade returns to normal.

Twenty years earlier, unfortunately, Italy had disregarded the necessity of not obstructing the flow of new money on to the market after a phase of sharp inflation. In fact, when a boom developed in 1925-26, with the external accompaniment of a fall in the exchange rate of the lira, exceedingly severe credit restrictions were imposed and the government of the day adopted as the target of its action, and saw a mark of success in, a strong reduction in the money supply, which started a very serious deflationary crisis.

Mr. Chairman, Ladies, and Gentlemen, I must apologise for having dwelt too long on events of the distant past which are generally well-known.

But, as I have already said, I was led to do so not only because I felt it my duty to recall the assistance given to us by Per Jacobsson but also because I wanted to show, through a brief outline of those past events, the pre-eminent role that was played in achieving the successful outcome by the foresight and courageous attitude of the man who led the battle. His was a shining example that may well inspire those who, as governors of central banks, have the noble task of ensuring the maintenance of stable money which, as Per Jacobsson aptly put it, goes hand in hand with a high level of civilisation.

THE ROLE OF THE CENTRAL BANKER TODAY

Lecture by

LOUIS RASMINSKY
Governor, Bank of Canada

WHEN I was invited to give this lecture I did not hesitate even long enough to protest my own unworthiness of the great honour. Anything associated with the name of Per Jacobsson called for an immediate and positive response from me. I knew him him well and admired him greatly. His own attitudes were invariably positive and constructive.

I first met Per Jacobsson in 1930, when he was leaving the staff of the League of Nations in Geneva to join the Bank for International Settlements in Basle. There he became the father confessor to the central bankers of Europe, and I know that many in this room benefited from his wise counsel and were cheered by his good humour. I saw a great deal of him during his years as Managing Director of the International Monetary Fund. He helped to move this institution to the centre of the world stage of international finance. To his task at the Fund he brought qualities of leadership that surpassed even what those who knew him best expected of him. He had a deep sense of history, but his basic attitude towards problems was always forward-looking. He maintained a life-long conviction in the paramount importance of sound money in the process of economic growth. Firmly grounded as he was in economic theory, he also showed a sensitive grasp of practical matters and practical possibilities, and he never allowed the best to become the enemy of the good. On a personal note, I can never forget his help during Canada's serious exchange crisis of 1962.

I have been asked to take as the subject of this lecture "The Role of the Central Banker Today." I propose to discuss some of the principal functions of the central banker as I see them, and to some of the main problems with which he is confronted today and which he seems likely to face in the future. What I shall say is essentially based on my own experience in Canada in recent years. I ask you to bear this in mind because I would not wish to jeopardize my friendly relations with my central banking colleagues in other countries by pretending to talk for them. In saying this I have in mind both my colleagues in the highly industrialized countries and in the developing countries, some of whom I have had the pleasure of seeing regularly at meetings of the Governors of the Central Banks of the American Continent and at Commonwealth gatherings. The role of the central banker is necessarily greatly influenced by the system of government, by the stage of economic development, and by the organization of financial markets; indeed, in underdeveloped countries, which are chronically short of capital, a great deal of the effort of the central banker may in fact be devoted to improving the structure of financial institutions so that the maximum amount of domestic savings may be mobilized for economically constructive purposes and the pressures for inflationary financing of development thereby reduced.

I am proposing to start this lecture with some very brief comments about the role of the central bank in the operation of financial markets. From there I shall move away from the world of finance towards the world of production and employment by outlining, again very briefly, my conception of how the monetary instrument operates and how it exercises its influence on the demand for, and the supply of, goods and services. This will lead me to a consideration of the relationship between monetary policy and other economic policies. In this section I shall develop the central thesis of the lecture. This is, that since monetary policy is just one element, albeit an important one, in over-all economic policy, the success of the central banker in using the instruments available to him depends primarily on the appropriateness of the whole set of economic policies: monetary policy cannot successfully compensate for the inadequacy of other policies. I shall then consider some of the practical problems that arise in achieving a proper coordination or mix of public economic policies. From this I shall move to some comments on the formal relationship between the central bank and the government. I shall then turn to some vexed problems of alleged conflicts between economic objectives and make some remarks about price stability and external equilibrium as objectives of economic policy.

The Central Bank and Financial Markets

In attempting a survey of the role of the central banker it is natural to begin with the position of central banks in the operation of financial markets. The powers accorded to a central bank, which enable it to influence the rate of expansion of the banking system, to act as lender of last resort to the banking system and the money market, and to act as banker and debt manager of the government, place it at the centre of the financial system. They make it a market-oriented institution. The central bank is naturally concerned that financial markets should function efficiently. They act as the channel through which the impact of monetary policy on the economy is transmitted and the channel through which the savings of the community are transferred to the ultimate users. In a world where a serious shortage of capital has become a chronic condition, concern about the efficiency of capital markets deserves high priority.

One way in which the central bank can make a contribution to the smooth functioning of financial markets is through the skillful handling of its own day-to-day operations. There is no set of rules to provide guidance here. A sensitivity to the working of the market is essential if the central bank is to take initiatives without producing perverse reactions and if it is to deal efficiently with disturbances that arise in financial markets for seasonal and other reasons. This sensitivity can be developed only through experience and must be supported by a steady flow of information from widespread contacts throughout the market.

The expertise which a central bank can develop in financial markets is of value not only in carrying out its own operations but also in assisting the government with its financial policies and debt operations. When the central bank's market expertise is reinforced by competent economic analysis it is able to participate fully and usefully in discussions of over-all economic policy.

The historic role of the central bank as the ultimate provider of liquidity in a financial crisis, is fortunately one of which we have heard rather little recently, but it is one that can never be completely absent from the mind of the central banker. Situations involving the danger of a spreading loss of confidence in financial institutions can still arise, though their origin may well be different than it was earlier in the history of central banking. In many countries institutions have grown up which are very much like banks in the sense that they obtain funds by issuing their own short-term obligations to the public and proceed to lend or invest these funds at longer term. These institutions usually lack a lender of last resort and they also differ from banks in the provisions governing their supervision, inspection, and liquidity. The central bank cannot, however, disregard any threat to confidence in the credit system, whether direct statutory powers or responsibility. An important part of the role or not the source of trouble is an institution within the central bank reserve system. It cannot be unconcerned merely because it has no of the central bank continues to be that of limiting the potential damage of shocks to financial markets and preventing extreme financial conditions from developing. Its concern with the liquidity position of particular classes of institution may, on occasion, have to be permitted to affect the course of monetary policy.

The question of the quality of credit, which is closely related to that which I have just been discussing, is one with which central bankers and other monetary authorities in all parts of the world have found it very difficult to come to grips. To a certain extent, the soundness of credit depends on the prevailing economic circumstances: credits that are perfectly sound under prosperous conditions turn out to be deficient if there is a chill economic breeze. But that is not by any means the whole story. A period of sustained economic expansion involving a substantial increase in the amount of credit outstanding brings with it the risk of a deterioration in credit standards — through the use of credit to finance basically unsound positions, or purely speculative positions, or positions involving an inadequate margin of equity, or through the use of excessive amounts of short-term credit for purposes for which long-term borrowing is appropriate. Though he is aware of these risks, the central banker can hardly refrain from encouraging an expansion of credit to facilitate sound economic expansion solely because of the possibility that some of the credit may be misused. He must, however, always be mindful of the risk of encouraging credit conditions so easy that credit deterioration becomes a widespread danger. He must do what he can to remind credit-grantors of the need for prudence and to encourage investors, even and perhaps particularly in conditions of high prosperity, to apply searching and sophisticated judgments in their appraisal of credit risks.

Mechanism Through which Monetary Instrument Works

I pass now to some remarks about the mechanism through which the monetary instrument works.

The objectives of the central bank in financial markets, and the smooth functioning of the financial system itself, are of course intermediate rather than final goals. In the last analysis, it is output, employment, and standards of living that matter. All central bankers must, therefore, proceed on the basis of some working assumptions about how the central bank exerts its influence on the level of economic activity. Views on this differ. Some central bankers concentrate their attention on the banking system for they regard it as the main potential source of monetary instability. They tend to focus attention on changes in bank lending and bank deposits, or the supply of money. For my part, coming as I do from a country where, in addition to banks, there are many financial intermediaries and other borrowers which issue claims on themselves of varying degrees of liquidity, I have found it useful to regard the central bank as exerting its basic influence through its impact on credit conditions generally — that is, on the cost and availability of money throughout the economy.

The way I look at the matter, the central bank can exert a pervasive influence on the whole range of credit conditions by its operations in financial markets. It can directly influence the rate of growth of the banking system, of bank loans, bank holdings of liquid assets and private holdings of deposit claims on banks. If the central bank encourages an expansion of private money holdings, the growth of non-bank financial institutions is also facilitated. The expansion of banks and other financial intermediaries and the attempt by the public to employ its money claims in other types of liquid assets exert downward pressure on interest rates and increases the availability of credit throughout the system. Similarly, if the policy of the central bank is directed to restraint, this tends to raise interest rates and affect the availability of credit throughout the entire financial system.

Decisions to spend money on goods and services are influenced to some extent by the conditions in financial markets which confront those who wish to raise money and those who may be willing to acquire financial assets as an alternative to spending money on goods and services. These decisions, in turn, affect output, employment and prices.

Decisions to borrow or invest outside one's own country are also influenced by changes in credit conditions.

This, in greatly simplified form, is the way it seems to me the central bank exercises its influence on economic behaviour. It is only one of several possible ways of looking at the monetary process and the impact of central bank action. But no matter how one looks at it, one thing is very clear. The impact of central bank action on credit conditions, of credit conditions on spending, and of spending on employment, output, price levels, and the external balance, is very complex. We need more reliable knowledge of the magnitude and the time path of the effect of central bank action. This can only come from intensive and sustained empirical research applied to statistics that are more up-to-date, more complete, and of higher quality than we now have.

A similar problem faces everyone with responsibilities in the field of economic policy. If policy actions are to influence the course of economic activity in the ways desired, the policy-makers must have up-to-date knowledge of what the economic situation is and they must know a great deal about all the main forces shaping economic developments. A decision to change some aspect of existing policies has to begin with an appraisal of the current position and a judgment as to what course future economic developments might otherwise take. In short, good policy requires good information and good forecasts.

The possibility of following rational economic policies depends crucially on a detailed and up-to-date knowledge of the facts, on the quality of the underlying economic analysis, and on the ability to look ahead into the future with some measure of confidence. I have to admit that it is in these respects that central bankers, like other economic policy-makers, often feel most inadequate. There is a great deal about economic behaviour which we simply do not know We have every reason to strive to get fuller and more up-to-date information, to understand it better, and to improve our ability to forecast developments. Impressive resources are being invested in continuing economic research throughout the world — in central banks, in governmental and international organizations, at universities, and elsewhere — and we can look forward to a steady enlargement of knowledge and understanding of economic relationships. But there is still no general agreement on how, and to what extent, and how quickly central bank action affects the behaviour of output, employment, price levels, and the external payments balance. So policy decisions have, unfortunately, to be taken in very much less than full knowledge of their consequences. The best that the central banker can do is to operate on the basis of a working view of the impact of monetary action which seems to him to fit the facts most closely. In framing his policy, he has to have a view of where the major risks facing the economy lie, and to be willing to alter his view in the light of new information received.

A number of economists, discouraged by the lack of precise knowledge to which I have been referring and profoundly mistrustful of the judgment of central bankers, have suggested that attempts to apply monetary policy in a discretionary manner should be abandoned. They have suggested instead that specific rules or criteria on which to base monetary operations should be adopted. These economists fear that if central bankers try to use monetary policy to moderate short-term fluctuations in demand, they are more likely than not to produce perverse results over a period of time. In their more extreme form the proposals of these economists would have central banks follow some very simple automatic rule, such as ensuring that the stock of money on some specific definition increases year in and year out, or indeed quarter in and quarter out, by a predetermined percentage. I must acknowledge that I do not consider these proposals realistic — I am afraid that it is impossible to encompass and resolve the full complexity of economic life in one or two very simplified relationships. The central bank has a responsibility to avoid the development of extreme financial conditions which would jeopardize the functioning of the financial system. In discharging this responsibility it may on occasion have to react to sharp shifts in investors' appetites for liquidity in a way which causes considerable short-term variation in the money supply. Though I do not regard the proposal for an automatic rule to govern the expansion of the money supply as a helpful one, there is something to be said for the view that central bankers should try to avoid over-reacting to minor and temporary shifts in the pressure of demand in relation to the economy's potential productive capacity, and that they should concentrate on using credit policy to help prevent more serious and prolonged bouts of underemployment or over-heating of the economy.

No doubt in time the search for more reliable guides to policy will provide the central banker with a better knowledge of the facts and a better understanding of the precise impact of his actions on various sectors of the economy. Empirical research can be expected to do much to reveal the nature of these relationships. But I feel very certain that at the end of the day, after the computer has had its say, there will remain a continuing need for the central banker to exercise his judgment.

Relationship of Monetary Policy to Other Public Economic Policies

In the course of the present generation, I think that central bankers have increasingly come to regard themselves as being concerned, not only with the management of the monetary instrument, but also with the way in which monetary policy is combined with other economic policies in the attempt to attain the broad economic objectives of the community. This shift in emphasis has arisen in part out of the continued accumulation of central banking experience. In part it results from developments in economic thinking and knowledge. It has been encouraged by the major reappraisals of the workings of the financial system that have been carried out in a number of countries. For the most part, however, it reflects the greatly increased responsibility that has been assumed by the governments of most countries, especially since the end of the last war, for the attainment of specific economic goals, and in particular for the maintenance of high levels of employment and rising standards of living of all sections of the population. This development has been accompanied by massive increases in public expenditure and in taxation which have proceeded to a point where in most Western countries 30 per cent or more of total national expenditure is made by governments or passes through the hands of governments in the forms of transfer payments to individuals.

With the growth of the public sector, government actions with regard to expenditure and taxation and the management of the public debt have come to have a very profound influence on the behaviour of the economy. Over the years, more and more attention has been paid to the way this influence can be exerted. I believe — and I hope I am not being too optimistic — that in recent years there has been a growing awareness that monetary policy is only one element in over-all economic policy, and that the chances of achieving desired economic goals depend very heavily on a proper combination of monetary policy and other elements in the totality of economic policy.

Since monetary policy is part of total public economic policy, its broad objectives must be the same as those of public policy generally.

These objectives would be regarded in most countries as including high levels of employment and domestic and external monetary stability. Recently, great emphasis has also been placed on growth and rising standards of living. The new emphasis on growth has had a useful result in focussing attention on policies which can increase the output of the economy by operating on the "supply" side, for example, policies which aim at increasing the mobility of resources and at improving the level of labour and management skills. As an inheritance from the 1930's, we have continued for too long to think of the maintenance of adequate monetary demand as the hall-mark of good economic policy. Enough demand is a necessary but by no means a sufficient condition of satisfactory economic performance. It is an encouraging development of recent years that governments are now prepared to consider very carefully the need for "supply" policies, including trade and tariff policies. These have a vital part to play in exercising a restraining influence on rising price levels and in improving rates of growth.

By their nature, however, "supply" policies are long-range in character and cannot be altered quickly. While it is of the highest importance that they be given adequate weight in the total "mix" of policies, and that they be co-ordinated with other aspects of public policy, it is in the area of monetary, fiscal, and debt management policies that the problems of co-ordination arise in their most immediate and continuous form. This subject matter was dealt with very elegantly in last year's lectures and I do not intend to traverse the same ground again. I would like instead to refer to some of the practical problems that arise in attempting the co-ordination of monetary and fiscal policy.

It is only realistic for the central banker to recognize that there are a number of factors that inevitably work from time to time against the achievement of the best balance between monetary and fiscal policy. Fiscal policy is on occasion influenced by considerations other than the general economic considerations that apply to monetary policy. Changes in taxes and in government expenditure have very direct and specific impacts on groups within the economy and are therefore subject to many pressures. While there is increasingly wide acceptance of the doctrine that fiscal policy should seek to stimulate the economy (for example, through tax reductions) in periods of under-employment of resources and should help to restrain it (for example, through tax increases) when the economy shows signs of over-heating, it appears that the first part of the prescription can be relied on with greater certainty than the second. To the extent that there is inadequate use of fiscal policy when the economy is over-heating, an extra share of the burden of restraint falls on monetary policy and, more importantly, the total job does not get done.

There is also a purely technical reason why this is a recurrent danger. This is the fact that in most countries, government expenditure plans are normally presented only once a year and tax rates are fixed by legislatures at that time. Between these annual dates, the burden of meeting any inadequacy of fiscal policy resulting from an original underestimate of the task to be performed, or from unexpected developments in the economic situation, tends to fall on monetary policy.

The effective co-ordination of monetary policy with fiscal policy is unusually difficult in federal states. A large share of government expenditure may be made by regional governments who feel less responsibility than national governments to use their fiscal power with considerations of the over-all state of the economy in mind. Where regional governments account for a large share of the total government sector the central government can seek to obtain their co-operation, but there is no doubt that the process of obtaining an appropriate "mix" of policies is more difficult in such circumstances.

I think that the general experience has been that in most situations where the aim of public policy has been to "cool out" the economy and keep the aggregate of monetary demand from rising more rapidly than the economy's real capacity to expand, an undue share of the burden of restraint has tended to fall on monetary policy. This was one of the main themes of the Report of the recent Royal Commission on Banking and Finance in Canada. They said:

> "Monetary policy is just not powerful enough to do the job by itself over any reasonable range of credit conditions, even if there were no international inhibitions about using it fully."

Most central bankers would echo this view. Indeed, the present situation in many of the large industrialized countries appears to provide a striking example of this. The main share of the load of trying to restrain the inflationary pressures which have emerged has again fallen on monetary policy, and interest rates have risen to levels which are very high by comparison with anything we have known in this generation. In many countries government financial requirements have increased the pressure on the capital markets. It seems clear that a different "mix" of policies to restrain the inflationary pressures, with less emphasis on monetary policy and more emphasis on fiscal policy, would have been better in the circumstances.

There is much more involved here than the discomfort of the central banker in pushing the use of the monetary instrument too far. It has to be remembered that changes in credit conditions do not affect all parts of the community in the same way. Large corporate borrowers seem, on the whole, to be likely to feel the direct impact of credit restraint less and later than small borrowers: large corporations normally have substantial liquid resources they can draw on and they have more ready access to the capital market if bank borrowing becomes difficult. There are differences in the ease of access of different categories of domestic borrowers in many countries to foreign capital markets or the Euro-dollar market, and there are differences in the response of different sectors of the economy to changed credit conditions. Housing expenditures are particularly likely to be affected by high interest rates. In addition to these inequalities, there is the real risk that excessive reliance on monetary policy may result in the development of financial conditions so extreme as to impair the functioning of the financial system and impede the flow of funds for productive purposes through capital and credit markets.

I would conclude and summarize this part of my remarks with two general observations: The first is that since the impact of monetary policy is more direct and powerful on certain sectors of the economy than on others it should not be pushed to extremes. It should be supported by and co-ordinated with other policy instruments in an over-all economic policy aimed at a rational combination of objectives. The second is that the appropriateness or inappropriateness of monetary policy cannot be judged in isolation but only in relation to the other public policies being brought to bear on the economic problems of the day.

Relationship Between the Central Bank and the Government

I turn now to the relationship between the government and the central bank. The formal status of the central bank varies a great deal from country to country. In any case this is a field in which the real inwardness of the situation is not likely to be revealed by the terms of the statute. Much depends on history and tradition and a fair amount even on the personalities involved. There is a variety of views as to the appropriate legal relationship between the central bank and the government. The extreme positions can be stated simply. At one end of the spectrum there is the view that the central bank should be little more than a technical arm of the Treasury, that no significant degree of independence for the central bank can be reconciled with the democratic process since the electorate must be able to hold the government responsible for every detail of public economic policy, including monetary policy. At the other end of the spectrum, there is the view that, human frailty being what it is, a wide separation between the power of the government to spend money and the power to create it is necessary if the latter power is not to be misused.

Between these two extreme positions there is room for varying degrees of independence for the central bank. My own opinion is that there are important advantages in arrangements under which the central bank has enough independence to insulate the management of its operations from the political side of government, and to ensure that the central bank can act as a formidable obstacle to the misuse of the monetary instrument. So far as basic policy is concerned, however, in most countries it would not be regarded as acceptable for the central bank to be able to thwart the government if the latter is prepared to take complete responsibility for bringing about a change of monetary policy in a way that causes the issues to be placed before the public in a clear and open manner. Arrangements which provide this degree of independence seem to me to have the advantage of putting both the central bank and the government in a position where there is no way in which either can avoid assuming responsibility for the monetary policy that is followed.

In Canada, where, as you know, we have had our problems in this area, the central bank has been operating for a number of years under the general arrangements which I have just outlined and I believe that on the whole they have worked well. In order that the relationship between the Bank of Canada and the Government can be clarified in law, an amendment to the statute governing the Bank of Canada is now being considered by our Parliament. The amendment makes it clear that there must be, as there is now, continuous consultation on monetary policy between the Government and the Bank. It provides a formal procedure whereby, in the event of a disagreement between the Government and the Bank which cannot be resolved, the Government may, after further consultation has taken place, issue a directive to the Bank as to the monetary policy that it is to follow. Any such directive must be in writing, it must be in specific terms, and it must be applicable for a specified period. It must be made public. This amendment makes it clear that the Government must take the ultimate responsibility for monetary policy and it provides a mechanism for that purpose. But the central bank is in no way relieved of its responsibility for monetary policy and its execution. The public should always be entitled to assume that if the Governor were directed to carry out a monetary policy which, in good conscience, he could not regard as being in the national interest, he would, after taking steps to ensure that the issues involved were placed clearly before the public, resign.

As I have already indicated, however, I do not believe that the real position of the central bank in government is determined by the statutory arrangements under which it operates. In the final analysis the influence of the central bank on economic policy depends on the respect it can command for the objectivity and cogency of its views as judged in the light of experience and on the proven degree of competence it displays in performing its own specialized role. It depends too on the contribution that it is able to make to the public understanding of economic and financial issues in analysing, in understandable terms, the complex forces operating at all times on the economy and in elucidating the basic rationale underlying the policies it has followed.

Price Stability as an Objective of Economic Policy

In the past two decades most countries have been having considerable difficulty in keeping prices under reasonable control. Not only have upward surges in price levels occurred when the economy was clearly overloaded but there has also been a persistent tendency for prices to move up even when capacity was not fully utilized. To some extent these developments have been encouraged by the great stress which modern economic thought has placed on the maintenance of demand as the key to successful economic performance, and by the increased role of government in providing through social security programmes and in other ways, a firm underpinning of consumer demand. The maintenance of incomes has resulted in large flows of savings, but the persistence of inflationary pressures in many parts of the world, including some of the wealthiest, indicates a continuous danger that the flow of savings will tend to fall short of what is required. Rising population and incomes involve enormous demands for capital for agricultural and resource development, and even in the most highly industrialized countries the requirements for infra-structural development, for the provision of adequate educational facilities, and for harvesting the fruits of modern large-scale technology will continue to grow. To this must be added the huge capital requirements of the under-developed countries.

A few moments ago I recalled that in most countries the goals of national economic policy are now taken to be high levels of employment, reasonably stable prices, a balanced external position and rising standards of living. Latterly, there has been a good deal of discussion on the question of whether these goals can in fact all be pursued with success at the same time, or whether some compromises — or "trade-offs" as they are called — may not be required. I am not proposing today to try to add to the extensive and scholarly literature that has developed on this subject, but I do wish to make one or two observations in what I fear some will regard as a rather dogmatic vein.

The question most frequently raised is whether there is not some inherent conflict between the maintenance of reasonable price stability and high levels of economic activity, and whether we should not be prepared to sacrifice the goal of stability in the value of money in favour of economic expansion. For my part, I think it would be more relevant and useful to ask whether maximum sustainable growth is possible if there are serious price increases.

The views that central bankers in all parts of the world have expressed from time to time about the development of inflationary pressures have led some to describe us as being characteristically more alarmed about the threat of inflation than about the threat of high unemployment. I would deny this accusation. I do not think that it is in accordance with the facts to regard the central banker as having an inflation "fixation," or as being determined to have price stability at no matter what cost in real output and unemployment. I suggest that the real difference between central bankers and those people who are not concerned about inflation is in their assessment of what can be achieved over anything but a relatively short period of time by tolerating a certain amount of inflation, creeping or even more rapid. It may well be the case that if rising price levels are tolerated, real output will in certain circumstances be raised for short periods of time. But the public authorities have an obligation to take a longer view. Once it became clear to everyone that public policy, even without any explicit admission, was prepared to allow prices to rise at, say, 3 per cent a year indefinitely, then all members of society, including savers, would take whatever economic or political action was available to them to protect themselves against this erosion in the value of money. In this situation the stimulating effect of the 3 per cent per year rise in prices would fade away and there would be pressure for additional expansionary measures. These would cause prices to rise faster than the so-called "acceptable" rate and the policies needed to keep the rise within the 3 per cent limit would appear to be "deflationary" and would be associated with just as much difficulty as the policies that were formerly necessary in the attempt to avoid inflation altogether. Where would the process stop? Would not the end be greater and greater rates of price increase, involving more and more inequity — since all members of society are in actual fact not equally able to protect themselves against inflation — and culminating in a major economic dislocation?

I find it disturbing to see some economists taking the view that everyone can adjust to inflation, and others trying to measure the costs of inflation in some past period in order to compare them with the costs of potential output foregone in periods of unemployment. These approaches assume that an inflationary system can produce better results over the longer run. I do not think it can.

It seems to me that what is needed is not to decide how much inflation can be tolerated but to concentrate on trying to find ways of making the economy work at satisfactory levels without rising price levels. It is clear that we have a lot to learn about living with prosperity without permitting it to degenerate into inflation. But I am not prepared to give up hope. We are not necessarily helpless because on frequent occasions in the past the economy has thrown up unacceptable rates of price increase when running at low levels of unemployment. Policies aimed at increasing the mobility of our resources and improving labour and management skills can help achieve stable prices by bringing about increases in productivity. Policies aimed more directly at relating the growth in incomes to increases in productivity and at limiting entrenched positions of market power may also be needed if we are to achieve a satisfactory combination of the goals of high employment and price stability. I know that this question is a very thorny and difficult one. There is the powerful argument that if monetary and fiscal policies prevent the emergence of excess demand there is no need for any special policy on prices and incomes, and if they do not do so such a policy will break down. There are, moreover, few brilliant successes to which one can point where income policies have worked when put to a rigorous test. But a basic assumption on which monetary policy, as well as fiscal and other policies directed towards affecting the level of aggregate demand, depends is that if total demand is not excessive, competition in the economy will ensure that reasonable price stability is maintained. If competitive forces cannot be relied upon to ensure that technical progress in production is reflected in the pricing policy of corporations and to keep income demands within reasonable bounds, that is, within the bounds of what the economy can really provide in the form of goods and services at reasonably stable prices, clearly some workable supplementary measures must be found. These supplementary arrangements cannot be a substitute for over-all policies which keep the increase in aggregate monetary demand within the real capacity of the economy to expand. But the experience of many countries suggests that monetary and fiscal policies need to be supported by some technique which mobilizes the force of public opinion behind non-inflationary behaviour by those who are in a position to deploy strong market power.

External Equilibrium as an Objective of Monetary Policy

I turn now, in drawing this lecture to a close, from the problems of domestic monetary stability to the problem of external stability. The two are obviously intimately related. If the authorities permit too great an erosion in the internal value of currency they are inviting a decline in its external value. The central bank is concerned with both.

In the heyday of the gold standard, half a century ago, central banks discharged their obligation to support the external value of their currency with surprisingly little in the way of gold and foreign exchange reserves. International flows of funds were very sensitive to movements in bank rate or to credit stringency produced by other means. Even if the mechanism of adjustment produced effects which were occasionally unfortunate on the domestic economy in terms of domestic levels of employment and output and prices, this was regarded as being in accordance with the rules of the game.

The situation today is completely different. The governments and peoples of all our countries are firmly committed to various goals in addition to exchange stability, and in particular to high levels of employment and economic growth. The central bank, as I have indicated, is one of the instruments for the achievement of the general economic goals of the community. Though it must continue to regard itself as being very much concerned with safeguarding the external value of the currency this is no longer its exclusive aim. It has to seek, as best it can, to work for a combination of monetary and other policies which achieves external balance without sacrificing the other objectives of economic policy.

Since the end of the last war we have in fact devoted a great deal of effort to setting up institutional machinery which is basically designed to help countries adjust to imbalances in their international position without having to take action destructive of national and international prosperity. Indeed, we may, on occasion, be inclined to lose sight of the enormous progress which we have made along these lines in all the attention that is focussed on the difficulties of particular currencies or on the need for further improvements in the international monetary system.

The International Monetary Fund stands at the heart of this system of collaboration. It has firmly established the principle that the level of exchange rates is properly a matter of international concern, it has established a code of good behaviour with regard to exchange practices, and it has mobilized large financial resources to help its members meet temporary balance of payments deficits and give them time to take corrective action when necessary. Under the Fund's General Arrangements to Borrow not only have large additional amounts of foreign exchange been made available which can be used to avert a threat to the international monetary system, but a forum has been provided in which, as in the Fund itself and in the OECD, the main industrial countries of the world can discuss in great frankness and detail problems of international liquidity and adjustment, and the impact of one country's policies on others. In addition to these new institutional developments, the traditional collaboration among central banks has been greatly expanded. Market-oriented as they are, and having a particular responsibility in regard to foreign exchange, the central banks of the main industrial countries have shown themselves capable of very rapid action in mobilizing support for currencies under speculative pressure and in helping to maintain exchange stability during critical periods. Under the leadership of the Federal Reserve System and with the useful collaboration of the Bank for International Settlements, there has developed a net-work of mutual currency holding or swap arrangements among the leading central banks. In their nature these arrangements have to be of a short-term character. Central banks can hardly impose conditions on the recipient bank for the support they provide in these credits, since the corrective action required may fall within the purview of the foreign governments rather than central banks. These credits cannot therefore be treated as a medium- or long-term source of financing payments deficits. They can, however, provide the time needed to work out medium-term credits with the International Monetary Fund or elsewhere and for the authorities to initiate whatever corrective action may be needed.

The impressive development of the machinery of international collaboration does not, of course, eliminate the need that countries will be under from time to time to take domestic action to correct imbalances in their international payments. No country can, over an appreciable period of time, carry out domestic policies which result in it using up real resources — in consumption, or private investment or government programmes — in excess of its own capacity to produce, except to the extent that foreign lenders or investors are willing to go on providing those additional resources. The fact that occasions arise when the need to maintain external equilibrium places some limitation on the domestic policies that can be pursued has led to a frequent allegation that there is some inherent conflict between domestic expansion and external balance, with the implication either that a country which is concerned with expansion should leave its external accounts to look after themselves or that the amount of international liquidity available should be so great that external considerations provide no limitation on domestic expansion. The latter is, of course, an illusion. International liquidity is a claim on goods and services, and there is no reason to suppose that the countries which would be called upon to make good these claims would be prepared to cover other countries' deficits on a continuing basis. The necessary pendant to international liquidity is balance of payments adjustment.

External balance is indeed an essential condition for achieving the domestic goals of economic expansion and rising living standards, and in a world which has been as successful as ours has been throughout the post-war period in maintaining high levels of economic activity, it is a fundamental error to regard these objectives as being in conflict. It is true that if a country is willing to ignore the external effects of its domestic policies, it has greater freedom of action in the short-run. But the foundations of future success in attaining the domestic goals of expansion are inevitably undermined by policies which lead to external deficits which cannot be covered on a sustainable basis, just as they are undermined by ignoring considerations of domestic monetary stability.

The task of reconciling the objective of external balance with domestic economic objectives is by no means a simple one and requires a willingness to deploy all the instruments of economic policy and to avoid excessive reliance on monetary policy. The simple case of a payments deficit which is due to excessive pressure of domestic demand does not raise any problem of conflict of objectives — in this case the payments pressure serves as an early warning signal which alerts the authorities to the need for restrictive action both for domestic and external reasons. Other circumstances call for a more sophisticated combination of policies. A country experiencing payments pressure under conditions of only moderate demand pressure and less than satisfactory employment, and whose exchange rate is not out of line, may require a stimulating fiscal policy to encourage domestic expansion combined with a restrictive monetary policy to attract capital inflows. A country which is experiencing a payments surplus combined with excessive demand pressure may require a combination of a strong fiscal policy to restrain the demand pressures and low interest rates to encourage capital outflows. To meet the challenge of so-called conflicting objectives, there is clearly need for enterprise in expanding the policy instruments and skill and resourcefulness in using them in concert. And this skill is needed not only in the countries which are experiencing deficits in their international accounts but also by those which are experiencing surpluses and are not subject to the same financial pressures to move in the direction of equilibrium.

I am afraid that we have not shown as much skill or as much determination in this respect as the situation has called for during the past few years. The great reliance which has been placed on monetary policy as the prime instrument for combatting inflation by countries which have been gaining reserves, as well as by those who have been losing reserves, has impeded the restoration of international balance and has led to a level of interest rates and a degree of international monetary stringency which carries with it all the disadvantages and the risks to which I referred a few moments ago. Not the least of these is the threat of a sharp strain on domestic and international liquidity leading to a major curtailment in the international movement of long-term capital for productive purposes from which the world has derived such great benefits during the past decade.

Central bankers have participated actively in the last years in the extensive discussions that have gone on concerning the next steps in the evolution of the international monetary system. These have focussed on the means of making the creation of international reserves a matter of international responsibility. I believe that sooner or later we shall have to take a major step forward in providing the machinery for creating reserves by deliberate collective action, and that it is important to resolve our differences about the precise form of such machinery as soon as possible. What we are seeking is more orderliness in the system of providing reserves and more scope for the exercise of judgment as to the amount and timing of changes in reserves outstanding. It would not be helpful, in my opinion, to create new machinery quite separate from the International Monetary Fund for this purpose. On the contrary, it is essential to preserve the central position of the Fund in the international monetary system. At the same time, the arrangements must be such as to ensure that the decisions taken are supported by a substantial majority of countries whose international trade bulks large in the total and whose currencies are widely used throughout the system. The form of the new reserves is a question of less significance. What is essential is to retain flexibility, and to move, as circumstances permit, toward the evolution of forms of international money that are generally acceptable. The aggregate supply should be brought under collective international control, and this control should be exercised in such a way that liquidity is neither so scarce as to force countries to restrictive or harmfully deflationary action to balance their international accounts, nor so plentiful as to encourage deficit countries to avoid dealing with domestic inflationary pressures and thereby help to spread inflation around the world. The success of any new arrangements we may agree upon will depend in large measures on the efforts of central bankers and their colleagues in government not only to deal effectively with their own problems but also to understand the problems of their opposite numbers in other countries, and to seek for solutions which take the general interest fully into account.

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The main theme that I have put forward in this lecture is that the central banker today is a public servant as well as a banker. His role is to operate one of the instruments of public policy for the attainment of the economic objectives of the community. He does not have a separate set of objectives of his own, though he must seek to influence the articulation of the community's objectives and the combination of policies chosen to attain them. He must also seek to reconcile his own and his country's policies with those of other members of the world community. This view of the role of the central banker was shared by Per Jacobsson, who always urged central bankers to remember that monetary policy was only one aspect of over-all policy.

I have denied in this lecture that the central banker has a fixation with respect to price stability, but I believe that many of us feel a special responsibility to act as the conscience of the community in this respect. No one else is likely to do so. Inflation in its early stages is popular, it creates a feeling of ebullience and well-being which does not tempt people to ask too many questions about the future. Keynes once said that the perfect standard of good manners for a gentleman attending a party is to maintain precisely the same level of sobriety or inebriety as the rest of the company. If this is so, then central bankers cannot aspire to be gentlemen. Their role, as Chairman Martin has said, is rather the unpopular one of acting as the chaperone who has to take away the stimulant just when the party is getting into high gear.

The central banker of today works in an imperfect world, with an instrument whose influence is only imperfectly understood, in seeking to attain objectives that can be defined only in broad general terms. It is not surprising that the profession is full of interest but not free of uncertainty and anxiety. I think that most of my colleagues would join me, echoing Pastor Rheinhold Niebuhr, in saying that what we need to play our role adequately is the serenity to accept what cannot be changed, the courage to change what should not be accepted, and the wisdom to distinguish the one from the other.

* * *

MR. BURGESS: I would like to tell you at this time that copies of the addresses you have just heard and of the discussions to follow will be available at the conclusion of the meeting, outside the hall, in three languages. In addition, the addresses will be printed in a booklet that will be distributed widely in many languages, both by the Foundation and by many central banks. Last year the lectures before the Foundation were printed in some eight different languages, and distributed in the thousands over a wide area.

Now we come to the discussion: our first discussor is a very distinguished Swedish banker. He is an internationalist, he is the President now of the International Chamber of Commerce, and he is also an industrialist. We all know him, and we are all delighted to have Marcus Wallenberg lead us in the discussion.

THE ROLE OF THE CENTRAL BANKER TODAY

Commentary by

MARCUS WALLENBERG

Vice-Chairman of the Board, Stockholms Enskilda Bank

THE SUBJECT of our discussion, "The Role of the Central Banker Today," supposedly has been chosen because there are reasons to think that this role is not the same as earlier. And, indeed, Governor Rasminsky has given us an excellent survey of many more or less new problems facing a central banker today.

For my part, I would like to concentrate on a certain aspect of monetary management which is closely connected with some specific features of modern Western societies. Let me start by drawing attention to some of these features — without attaching any valuations. Let us just look around.

First of all, we find that high and stable employment is one of the primary goals of all governments and — perhaps even more important — that most people think that the governments have not only taken responsibility for full employment policies, but also will always be in a position to sustain or restore full employment.

Secondly, we find that in every country there are ambitious political goals as regards resource allocation — i.e., expanding public sectors, as well as income redistribution. Centralized political decisions are currently taken in order to change the pattern of production and consumption without giving up completely the market mechanism and without materially altering the private enterprise system or limiting labor market organizations' freedom of action. This is, as you all know, the essence of what is sometimes called the "mixed society."

Now, I am coming to my first question. Is there a mechanism available to reach these rather ambitious targets without creating imbalances and other distortions resulting from overstrain of the resources? This is, of course, a question of economic policy, mainly budgetary, fiscal, and monetary policy. Well, in my view the available mechanism today is fraught with important limitations. These limitations have little to do with the techniques of economic policy. There is ample evidence that the problem cannot be solved by avoiding a few easily apparent mistakes or by using some ingenious economic policy weapons. The problem is too deep-rooted in modern society.

The fundamental problem seems to be a built-in conflict between, on the one hand, centralized political decisions taken by the elected representatives of the people and, on the other hand, the reactions of more or less free markets and of human beings, groups and organizations in a society that is not completely regulated. This conflict becomes apparent as difficulties arise, due to lack of mobility of the factors of production and to stickiness of markets, when trying to reallocate resources. Furthermore, in other areas of economic life, reactions against centralized political decisions come from human beings and groups who are unwilling to foot the bill. These reactions take many forms, one of the most important being endeavours to increase money incomes in order to compensate for higher taxes. Now, in a society where high and stable employment is more or less guaranteed by the government and where there are strong labor organizations, these endeavours are very likely to be at least partly successful. This means inflated money incomes and increased demand, but also higher tax revenues than expected. By some sort of political law — but contrary to prevailing fiscal theories — this usually results in even more public spending and further demand expansion.

Through this inflationary sequence the central bank is to a great extent confronted with a *fait accompli* and brought into a rather awkward position. This is so particularly as there is not necessarily any money and credit creation involved as a causal factor in this process. Instead there usually is enough short-run elasticity within the monetary system to allow the inflationary process to start and to gain a certain momentum. On the other hand, the central bank certainly has the last word in a technical sense, as no inflation of any kind can go on for a long time without a substantial increase of the money supply. But the *fait accompli* does mean that the central bank will repeatedly have to put on deflationary pressures to reduce money incomes which have already been inflated. This task, indeed, is much more difficult — both technically and, first of all, politically — than to avoid creating excess liquidity and credit expansion. The central bank will be faced with a conflict of inconsistent economic policy goals: a money squeeze to deflate the economy will sooner or later hurt business excessively and unwantedly since the basic inflationary forces are not due to general business conditions, to sellers' markets, and to profit inflation, but to the public sector and to the mechanism I have just tried to explain.

What kind of general conclusions can be drawn from this interpretation of what is going on in our economies? Well, I think this is a complicated matter. There are no simple solutions to be found if we keep to realities.

As to the role of the central banker, it should be stressed that the working of the present-day inflationary mechanism assuredly does not justify the conclusion that monetary authorities should abstain from putting the economy under a certain deflationary pressure as soon as this is called for by the *fait accompli.* Such abstention would very easily result in a self-generating inflationary process on the top of the basic mechanism. A more general and cumulative demand and profit inflation would be added to the basic demand and cost push inflation. As you all know, this is what really happened in most countries in earlier post-war years when easy money policy was highest fashion. Now, fortunately this has been changed. But there is, indeed, a limit to the feasibility and suitability of a persistently restrictive monetary policy, given the basic forces just mentioned. This limit creates, as I said, a crucial problem in many countries today.

With this background, it seems quite clear that it is an important duty of a central banker to leave no ways and means untried to make the politicians aware of the real limitations of centralized political decisions in a mixed society, where there are no efficient economic policy means at hand to reach all the goals. It is part of his pedagogic task to try to keep this very first line of defense against inflation by pointing out the fact that conventional fiscal and monetary measures, as well as unconventional ones, are doomed to become labours of Sisyphus when there are, at the same time, very rapidly expanding public sectors and government budgets. I think this is his task in particular, as almost anybody else who is arguing on the same line unfortunately is too easily suspected of having purely political intentions, hidden subjective valuations or, even worse, of contending for vested interests — the sad experience of many professional economists and businessmen. Even though a central banker certainly is not protected from all such suspicions, he has a better position, or at least a better platform, to act from.

There are some other aspects of the role of the central banker today that deserve mentioning. Close contact should be kept, not only with governments and politicians, but also with businessmen, bankers, and economists. A central banker has to spell out the reasons behind the monetary policy actually pursued and to explain the implications of the measures taken. Here, too, his pedagogic task is of great importance. There is also a need for meaningful discussions of current business trends at home and abroad. Furthermore, there are often reasons to discuss the functioning of the money and capital markets as well as their improvement. All this leads to the general conclusion that, not least in our mixed societies, a central bank's cooperation with Government, with organizations, and with business, in its widest sense, at home, is most desirable, although in some cases delicate. International contacts between central banks in recent years have widened and have resulted in important fruitful international cooperation; this shows the way to similar cooperation on the respective home-fronts.

What has here been said about a built-in and deep-rooted conflict of economic policy goals and means in modern societies should not be taken to mean that the central bank is bound to have much less influence than earlier. The role of the central banker is of utmost importance, but his task has no doubt become more difficult. There may be economic weaknesses in every economy that cannot possibly be cured by wise monetary policy, but certainly healthy economies can be impaired, not only by unfortunate central bank action, but also by lack of action.

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MR. BURGESS: Thank you, Mr. Wallenberg. I know our central bankers here will be cheered by your words, which give them additional courage to carry out the essential central bank duties. I did not tell the audience, when I introduced Mr. Wallenberg, that he is a Director of the Per Jacobsson Foundation; he shares these responsibilities with Pierre-Paul Schweitzer, the Managing Director of the International Monetary Fund, here on my right, and Gabriel Ferras, the General Manager of the Bank for International Settlements, on my left, so that four of the Directors are here today. The other one, Eugene Black, is in Asia, working on the inauguration of the new Asian Development Bank, so we have to forgive him for not being present.

Now, we move on to the second discussion, by Dr. Franz Aschinger, the Financial Editor of the *Neue Zürcher Zeitung*. I am sure you have all read his words of wisdom, he is certainly qualified as one of our very wise financial commentators and economists, and we are delighted to hear from him today.

THE ROLE OF THE CENTRAL BANKER TODAY

Commentary by

FRANZ ASCHINGER
Financial and Economic Editor, Neue Zürcher Zeitung

LET ME SAY at the outset how honored I feel at the invitation of the President of the Per Jacobsson Foundation to speak before this distinguished audience. I had the privilege of knowing Dr. Jacobsson for nearly 30 years, I admired his wisdom and his diplomatic talent and I shared his basic philosophy. To speak as an outsider before central bankers on their proper role today is for many reasons a delicate task. I shall confine myself to a few remarks on the role of the central banker, as it is generally seen by the public, and how I see it myself. And in doing so, I shall follow the threads set by Governor Rasminsky in his excellent paper.

While central banks, under the classical gold standard, were just expected to conform to the "rules of the game," central banks exist today — to use an expression of Professor Sayers — for the very reason that there are no such rules any more.[1] To the extent possible by means of their discretionary monetary powers, central banks must seek to meet the various objectives of economic policy. As Governor Rasminsky has said, monetary policy is part of total economic policy and its broad objectives must therefore be the same as those of public policy generally. A preliminary question is whether the so-called magic triangle of economic objectives, to which many countries have pledged themselves, is consistent within itself. I would not, in principle, deny its compatibility, provided that the different goals — high-level employment, sustained growth and internal and external stability of the value of

[1] R. S. Sayers, *Central Banking after Bagehot,* Oxford at the Clarendon Press, 1956.

money — are not aimed at in absolute terms and provided that not all of these goals are given first priority at the same time. If, however, in practice many tensions have arisen between these objectives, it is because these conditions have not always been respected by governments and by public opinion.

It is in such moments that the central banks must perform a primary equilibrating function. If full employment and growth policy are pursued at the expense of internal and external stability, as often happens, central bankers must point out that — to use Per Jacobsson's *ceterum censeo* — "stability is the true basis of a lasting high level of employment and of sustained growth." "Economic growth" — he said — "can be compared with the construction of a good home, with stability as its foundation. To introduce monetary stability is often only the beginning of the efforts needed to achieve growth."[2] Again and again central bankers must repeat that stability, if rightly understood, is a prerequisite and a means, not an obstacle to growth. They must take a longer-term view, must sound warnings and take flexible actions at times when inflationary dangers are only in a developing stage. This often puts them in conflict with politicians and the public who take a shorter view. In order to succeed the central banker must have courage and a firm stand.

In his paper today Governor Rasminsky denied that the central banker has a fixation with respect to price stability. But he emphasized that many central bankers feel a special responsibility to act as the conscience of the community in this respect, as no one else is likely to do so. This balanced view seems to me to contain the main elements of the crucial question. There is certainly no central banker who would like to obstruct the sustained progress of the economy, let alone to create recession. Nor do I know of any contemporary central banker who fixes his eyes exclusively on price stability, neglecting the other objectives of economic policy. But his specific role is no doubt to be the guardian of the internal and external value of the currency and to watch the balance of payments situation. This function is inherent in his assignment to look after the good management of money and to prevent disturbances which could arise in the field of money. Money in the market economy can perform its role properly only if reasonable stability of its value is preserved.

[2] Per Jacobsson, Speech at IMF Annual Meeting in Vienna of September 18, 1961.

"Its paramount task" — that is again how Per Jacobsson described the central banks function in this respect — "is to safeguard the integrity of the national currency," and he added that it "may take only such measures as are compatible with the safety of the currency."[3] Mr. Blessing's recent statement that "the banks of issue's duty is to defend the currency and its purchasing power"[4] is identical with this view. And the same opinion is reflected in Signor Carli's words that "the Central Bank has the task of the institutional protection of savers."[5]

In countries, like Germany, which in one generation suffered several devastating inflations and where stability has a higher priority than in other countries, this role of the central bank is naturally more emphasized. And the central bank's freedom to impose monetary restrictions is here more explicit than in countries like the United States, where until recently unemployment was abnormally high and where also the central bank considered it as its first objective, to foster domestic economic growth, even at the expense of the balance of payments. It is due to these different circumstances that the role of the central bank in the United States had for a long time been seen in a somewhat different light than in continental Europe. It is symptomatic that in 1963 in a public letter, Professor Samuelson warned a young central banker: "Stop being jockeyed into the underdog position of the last defender of the stability of the price index."[6] But even in the United States the specific task of the central bank to defend stability is recognized by public opinion. The *New York Times* in the summer of 1965 defined the task of the central banker as follows: "It is his job to promote expansion by protecting the purchasing power of the dollar."[7]

How deeply rooted is the trust of the public in the primary role of the central banker as the defender of the currency becomes clear in moments of crisis when the balance of payments is at stake and when stability has to be given first priority, as is at present the case in the United Kingdom. "The influence of the Bank of England," that is how *The Economist* put it, "requires extra dimensions in a period when sterling is shaky.

[3] Per Jacobsson, lecture given in Reykjavik on September 17, 1954.

[4] K. Blessing, "Between Euphoria and Reality," speech given before the Law and Economics Faculty, Johannes Gutenberg University in Mainz on February 24, 1966.

[5] G. Carli, "Problems of Today," speech before Anglo-Italian Parliamentary Group, House of Commons, London, on June 28, 1966; reprinted in Banco di Roma, *Review of the Economic Conditions in Italy,* July 1966, p. 272.

[6] J. Dewey Daane, "The Role of a Central Banker," speech in Boston on July 14, 1966.

[7] *The New York Times,* June 4, 1965.

The Governor of the Bank can then, so to say, speak for the pound itself. At such times, the Governor can in truth be the most powerful man in London."[8]

But the central banker in the position of the strong man is a rare and rather temporary phenomenon. More frequent are the cases where the central banker feels too weak to carry out his role vigorously, where he has not sufficient independence from the government, where he has not strong enough monetary instruments available, where his monetary measures are not backed by fiscal policy or are even counteracted by it, and where the central banker feels alone because he does get not enough support from the public.

Mr. Rasminsky has given a comprehensive picture of the limits and defects monetary policy is meeting today. I want to take up only two points of his remarks. I fully agree with his main thesis, that monetary policy should be especially complemented by fiscal policy. Monetary policy cannot bear the whole burden nor would it be good to use monetary weapons to extremes. But the deployment of fiscal policy as a means of stabilizing policy is not an easy task. The idea that taxes, for reasons of economic stability, should be cut one year and increased the next year, or varied even in the course of the budget year, has in many countries not yet entered the spirits either of the politicians or of the public. And it has — as Governor Rasminsky rightly said — gained even less ground at the member-state and community government levels within federal nations. Not to speak of referendum democracies, as my own country, where taxes have often to be submitted to plebiscite and where the mechanism for changing taxes is very time-consuming. There are also limitations to the possibilities of varying public expenditure as a stabilizing instrument. These limits, however, do not obviate the effort to make the fiscal instruments more flexible.

Coordination between monetary and fiscal policy is relatively easy in pure demand cases, where balance of payments deficits coincide with demand pressures or payments surpluses with deficient demand. There a "mix" between monetary and fiscal policy must aim in the same direction and supplement each other. But there are other cases where deficits coincide with deficient demand, while surplus countries are faced by inflationary dangers. In such cases fiscal policy is designed to compensate for the undesirable internal effects of monetary policy or to replace it.

[8] *The Economist,* December 4, 1965.

Obviously, the possibilities and the effectiveness of such combinations are limited. The recent remarkable report of Working Party III of the OECD on the improvement of the adjustment process, recognizing this, expresses the view that there can be occasions when adjustment of the exchange rates may seem a preferable alternative.

Turning to Governor Rasminsky's remarks concerning the relationship between the central bank and the government, I strongly support his opinion that there are decisive advantages in arrangements under which the central bank's operations should be isolated from political pressure, so as to impose an obstacle to the misuse of monetary policy. The government, being an important borrower and a party in matters of credit policy, should not be its own and exclusive master in this field. Where the central bank is more removed from political influences and more independent from Treasury problems, it can use its better knowledge and technical experience of financial markets and of the implications of monetary policy to act more objectively in monetary matters. Of course, constant consultation is necessary between the central banker and the government. But the government should listen to the technical advice of the bank, while the bank should have the power to close the door in case of imminent danger of abuse of monetary policy. The days, when Sir Montagu Norman could proudly say "I look upon the Bank as having the unique right of advice and to press such advice even to the point of nagging, but always of course subject to the supreme authority of Government" may have passed, at least under normal conditions; nor, fortunately, has Sir Stafford Cripps' remark in 1946 that the governor of the central bank is not his adviser, but his creature, become a common and lasting rule. Even though the abdication of central bankers and their formal submission to the finance minister has been called for in many countries from time to time, the ideal has prevailed that it is in the general interest to preserve their independence from the government. The French would say: *"Vive la petite distance!"*

But the danger of political influence on the central bank increases with its better monetary equipment. In Switzerland, for instance, where a bill is at present being submitted to invest the bank of issue with supplementary powers, it has been suggested to store the new monetary weapons in the central bank, but to reserve the right of decision on their use to the committee of the Bank's council, consisting of political and economic representatives. To entrust monetary laymen with such powers is certainly not better than it would be to transfer the decision-making-power directly to the government.

Before closing, let me add a few words on the international role the central banks have recently acquired under the managed currency system. By building up an international monetary fire brigade through the gold pool, swap networks, and other borrowing arrangements to be used in case of a major currency crisis, the central banks of the industrialised countries have, in recent years, no doubt contributed to preventing a breakdown of the fixed exchange rate system that might have come from speculative pressures on important currencies. As it gives comfort to everybody to know about the existence of a well-equipped fire brigade, these actions have hitherto been met with sympathy or at least with little criticism by the public. But there is a clear limit of the actions which a fire brigade must not exceed. It must extinguish the fire, but it has to leave the rebuilding of the house to other people. Central bank assistance can by definition be only of a short-term character; it cannot be tied with all sorts of economic conditions and must in due time be replaced by other conditional longer-term measures. Though the monetary deterrent of swap stand-bys must be able to smash large speculative movements, the recent increase of the swap network has clearly shown that in this field we are nearing practical limits.

The impressive development of the machinery of international collaboration does not — as Mr. Rasminsky rightly said — eliminate the need for countries to take domestic action to correct imbalances in their international payments. I would go even a little further and say that improvement of the adjustment measures to restore the balance of payments situations is today the most urgent and important need in the monetary field and that it deserves at least as much attention as the question of international liquidity. To be sure, the necessity of deliberate creation of supplementary reserves can, in principle, not be denied and contingency planning in this direction is certainly not inappropriate. The necessity of such an action could not only occur due to the disappearance of the U.S. balance of payments deficit but already if a greater part of this deficit would have to be paid in gold. Yet, it should be the specific role of the central bankers as the defenders of monetary stability to ensure that the new international monetary machinery will not itself become an engine of international inflation. In this they would be performing the same special function as on the internal front.

In a study on international monetary problems, Per Jacobsson came to the conclusion that, by and large, the influence of the central banks has been on the side of the angels.[9] If this be true — and I would not disagree — then heaven must be full of central bankers, these earthly scapegoats.

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MR. BURGESS: Thank you very much. We are again gratified at finding that central bankers are not being severely attacked here today either by industrialists or by editors; editors, you know, have sometimes written about us very critically. I think that you, Dr. Aschinger, have been very kind.

Now I think we should give Governor Rasminsky a chance to respond briefly. Also, he has received one or two questions from the audience. So, again I call on Governor Rasminsky.

[9] Per Jacobsson, *Some Monetary Problems, International and National,* Oxford University Press, 1958.

THE ROLE OF THE CENTRAL BANKER TODAY

Response by

LOUIS RASMINSKY

LADIES and Gentlemen, having in mind the hour and the hospitality that awaits us, my response is going to be very brief.

We have listened to two very remarkable interventions from Mr. Wallenberg and Dr. Aschinger. I think it was very foresighted on the part of the organizers of this meeting to have arranged for a leading banker and industrialist and a leading economic journalist and editor to state how the subject matter looks from the point of view of private financial interests and from the point of view of the general public. Their observations will be well worth studying carefully in the printed proceedings of this gathering.

I found that their comments were, in general, very much in line with those that I had made. Mr. Wallenberg brought out the very difficult decision that may confront central bankers in aiming at monetary stability and sustained economic expansion — the choice of going along with the inflationary impulses generated outside the part of the system that is under the direct control of the central bank, or of using the full powers of the central banking instrument to check these tendencies, with resulting economic dislocation and unemployment. This is the cruelest choice of all. The general prescription that Mr. Wallenberg has suggested falls into two parts: one, to use the influence of the central banker with government to bring home certain basic economic truths, to try to influence government policies so that the total demands on the economy will remain within the level of the available resources or the potential productive capacity of the economy; and, on the other hand, to try to influence public opinion in the private sector of the economy along economically realistic lines. I agree with Mr. Wallenberg that these, apart from the deployment of his own instrument in an appropriate way, are the lines of action that are open to the central banker.

I think that Dr. Aschinger was quite right in saying that the relative emphasis put on one or the other of the objectives of economic policy will vary according to the economic background or the economic history of a particular country. The example that he has cited of the great emphasis on the primary requirement of price stability in countries which have undergone severe inflation is a very appropriate one. The central banker, as I indicated in my lecture, has reasonable price stability as an objective without sacrificing the other economic objectives of the community, including the objectives of sustained growth, external stability, and high living standards. The way that I would look at this is embodied in a very wise quotation from Per Jacobsson, that Dr. Aschinger referred to, to the effect that monetary stability is the road to expansion, that it is a necessary condition of economic expansion, and that you want both monetary stability and economic expansion.

The other point in Dr. Aschinger's comments that I would like to refer to is the matter of the independence of the central bank. It seems to me that the meaning of independence of the central bank is not an independence *from* government, it is an independence *within* government. The central bank is a part of the apparatus of government and, within that context, it must find — and these will differ from country to country — arrangements which permit it to use its powers effectively and without political interference. But I do not think this can effectively be done in a way which results in a continuous conflict or opposition between government and central bank. I insisted in my lecture that both government and central bank must regard themselves as responsible for the monetary policy that is followed.

There have been three or four questions from the floor. I think that perhaps the question that was sent in before the meeting regarding the powers of the governor of the central bank has, in fact, been answered in my lecture, and in the course of these remarks.

Another questioner asks whether, in an international community which inflates at 3 per cent per year, it is not the case that the real choice for a country seeking internal stability is to inflate at the same rate or to allow its currency to appreciate on the exchange market. He then wonders which of these courses I would suggest. In the first place, I doubt that the rest of the world could continue an inflation of 3 per cent a year:

it is an unsustainable position. I would think it might increase, break down, and start over again, but I do not think it could go on at 3 per cent, year after year. But if the world is inflating at that rate, no country can effectively stand completely aside from it, because its price level will be determined in part by the prices of imported goods, and in part by the prices that its own goods fetch on markets over the world. A certain price rise, even in a well-run country which attempted to stand aside from world price movements, would probably be inevitable. I would think that the objective in such a case would be to seek to prevent domestic sources of inflation from adding to those price increases that are, in the circumstances, necessarily imported from abroad. Whether that eventually means a need for a realignment of exchange rates would of course depend on what is happening in the rest of the world. But in this hypothetical case, if the choice were between some upward pressure domestically generated on prices and a rise in the value of currency, I would think that the country might find it possible to pursue its goals of domestic economic expansion with some moderate upward adjustment of its currency in the light of what was going on in the rest of the world.

Another questioner focusses attention on the relationship between the process of domestic saving and the export of capital which, among other factors, may be affected by exchange control regulations. He suggests that it would be very useful if the observations that Per Jacobsson made on this subject in the course of his years as Managing Director of the International Monetary Fund were collected in one place and made available to students, and I bring this to the attention of the Foundation.

Mr. Chairman, in concluding I would like to do two things: I would like, first, to express my very deep appreciation to the Italian Bankers' Association for their great hospitality and assistance in the course of this meeting; Dr. Siglienti has been extremely kind, and Dr. Calabresi has also done much effective work in connection with this meeting. The Association was responsible for the Italian translation of this lecture; my colleagues in the Bank of Canada who are better educated than I am assure me that the Italian style is far superior to the English.

The last thing that I should like to do, if I may, is to express my appreciation to the audience for the way in which my lecture has been received. I would like to say also how pleased I am that so many people have come from outside Italy. I realize that this is in the nature of a tribute paid to Per Jacobsson, but it has been very pleasant and gratifying for me. Thank you very much.

CLOSING REMARKS

by

W. RANDOLPH BURGESS

THE RESPONSE of this audience is a clear indication that Mr. Rasminsky has made a most successful presentation of this subject.

This question period has had a special advantage in demonstrating that the discussion, which has kept very carefully to principles, has a very direct bearing on the problems of today. One of today's problems for a central banker is what to do when you have a 3 per cent rise in prices going on in a whole group of other countries, as is the fact today. What has been said here this morning is a sound statement of the principles for dealing with that situation. Hence, I believe that you all will value the texts of these statements, which will be available at the conclusion of this meeting and will also be published.

It was suggested that some of the things that Per Jacobsson had said on this general subject should be made available. We have selected from his works some quotations on the role of the central bank, and this collection of excerpts will also be available outside the hall after the meeting. We are glad to have received the suggestion that a selection should also be made of his writings on the question of savings and investment; we will explore that matter.

Now, three or four announcements: The next lecture will be in Rio de Janeiro on September 22nd, 1967, just two days before the next meeting of the Bank and Fund. Many of you will be there to attend the Bank and Fund meeting. Rio is a very pleasant city to spend a couple of extra days, so do plan to come and attend the Per Jacobsson lecture in addition. In 1968 we are invited to go to Sweden. The Riksbank on that year will celebrate its three-hundredth anniversary, so we must all be there to help them.

Now, I think, there is nothing to prevent us from adjourning and accepting the hospitality of the Italian Bankers' Association. I might remind you that the Bank of Italy is also extending its hospitality this afternoon at five-thirty. I know that we all want to express our gratitude to them both.

This meeting is adjourned.

Appendices

BIOGRAPHY OF LOUIS RASMINSKY

LOUIS RASMINSKY has devoted his career to the fields of international economic affairs and central banking. He joined the staff of the Economic and Financial Section of the League of Nations in 1930 as a specialist in monetary and banking problems, became Secretary of the League's Financial Committee in 1938, worked with the League Mixed Committee on Nutrition, led a Financial Mission to Bolivia in 1939, worked with the Fiscal Committee of the League in 1940, and with the League's Delegation on Economic Depressions which reported in 1941.

In 1940, Mr. Rasminsky joined the Bank of Canada. He organized the Research and Statistical Section of Canada's Foreign Exchange Control Board and in 1942 became the Board's Alternate Chairman and Chief Executive Officer. He was the Executive Assistant to the Governors of the Bank of Canada from 1943 to 1954. Mr. Rasminsky served as Chairman of the Drafting Committee on the International Monetary Fund, Bretton Woods Conference, and was an original Executive Director of the Fund, acting in this capacity until 1962. He also was an Executive Director of the International Bank for Reconstruction and Development, 1950 to 1962, the International Finance Corporation, 1956 to 1962, and the International Development Association, 1960 to 1962. He was a member of the Canadian delegations to the United Nations founding conference in San Francisco in 1945, to the UN General Assembly, and the Economic and Social Council in 1946. He has participated in Commonwealth Finance Ministers' Conferences since 1949, the Commonwealth Prime Ministers' Economic Conference of 1952, the Commonwealth Economic Conference of 1958, and in all meetings of the Joint Canada-United States Committee on Trade and Economic Affairs and of the Canada-United Kingdom Continuing Economic Committee.

Mr. Rasminsky was appointed Deputy Governor of the Bank of Canada in 1955 and Governor in 1961. He is Alternate Governor for Canada of the International Monetary Fund and the International Bank for Reconstruction and Development.

Born in Montreal, Quebec, in 1908, Mr. Rasminsky was educated at the University of Toronto which granted him an Honorary LL.D. in 1953, and the London School of Economics, of which he was made an Honorary Fellow in 1959. He is also an Honorary Doctor of Humane Letters, Hebrew Union College, New York.

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JOHAN MELANDER — Norway — Managing Director, Den norske Creditbank

DONATO MENICHELLA—Italy—Honorary Governor, Banca d'Italia

EMMANUEL MONICK—France—Honorary President, Banque de Paris et des Pays-Bas; former Governor, Banque de France

JEAN MONNET — France — President, Action Committee, United States of Europe

WALTER MULLER—Chile—Former Chilean Ambassador to the United States

JUAN PARDO HEEREN — Peru — Former Minister of Finance

FEDERICO PINEDO—Argentina—Former Minister of Finance

ABDUL QADIR—Pakistan—Former Governor, State Bank of Pakistan

SVEN RAAB — Sweden — Managing Director, Göteborgs Bank

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