HINC ROBUR ET SECURITAS

THE PER JACOBSSON FOUNDATION

May 16, 1968
Konserthuset-Stockholm

CENTRAL BANKING AND ECONOMIC INTEGRATION

Lecture delivered by: DR. M. W. HOLTROP

Commentary by: The Rt. Hon. The Earl of Cromer, P.C., M.B.E.

PJF. 1968

C E N T R A L   B A N K I N G

A N D

E C O N O M I C   I N T E G R A T I O N

Lecture delivered by

Dr. M. W. Holtrop,
Former President, De Nederlandsche Bank

Commentary by

The Rt. Hon. The Earl of Cromer, P.C., M.B.E.,
Managing Director, Baring Brothers & Co., Limited

May 16, 1968
Konserthuset -- Stockholm

FOREWORD

The 1968 Per Jacobsson Foundation lecture was given in Stockholm on Thursday, May 16, 1968, as part of the four-day program celebrating the 300th anniversary of the Sveriges Riksbank. The main speaker, on the subject "Central Banking and Economic Integration", was Dr. M. W. Holtrop, former President of the Bank for International Settlements and former President of De Nederlandsche Bank. Comments on Dr. Holtrop's paper were offered in a statement given by The Earl of Cromer, Managing Director of Baring Brothers & Co., Limited, and former Governor of the Bank of England. The Governor of the Sveriges Riksbank, Per Åsbrink, opened the proceedings. The texts of these statements are included in this publication, which is being issued in English, French and Spanish.

The Foundation was established in 1964 to carry forward the ideas which Per Jacobsson had contributed to the promotion of international monetary cooperation during his brilliant career in the Bank for International Settlements and the International Monetary Fund. Its financial support has come from contributions made by international institutions, by governments, by central and commercial banks, and by corporations and individuals throughout the world. Lectures sponsored by the Foundation have been held every year since its creation, in Basle, Washington, Rome, Rio de Janeiro, and now in Stockholm. The Proceedings of these lecture meetings have been published by the Foundation in French, English and Spanish and distributed without charge. Through the courtesy of other interested institutions, texts have also been made available in Chinese, Japanese, Italian, Hebrew and Persian. Titles of the lectures given so far, together with names of the speakers and information on the availability of Foundation publications, are given on the inside back cover of this booklet.

TABLE OF CONTENTS

	Page
Welcoming Remarks by Per Åsbrink, Governor of the Sveriges Riksbank	1
Opening Remarks by W. Randolph Burgess, President of the Foundation	3
Lecture by M. W. Holtrop	5
Commentary by The Earl of Cromer	22
Closing Remarks by W. Randolph Burgess	29
Written comments received from:	
Otmar Emminger	30
Robert V. Roosa	31
E. Stopper	32
Appendices:	
A. Biographies of Dr. Holtrop and Lord Cromer. . . .	37
B. List of Sponsors, Directors and Officers of the Foundation	39
C. List of Publications distributed by the Foundation	43

WELCOMING REMARKS

by

Per Åsbrink, Governor
Sveriges Riksbank

I take great pleasure in welcoming to Stockholm so many old friends gathered here today in the name of The Per Jacobsson Foundation. I welcome not only those on this platform with me, whom Mr. Burgess will introduce, but also the many friends I see in this audience. Amongst those I particularly want to welcome to our city and to our hearts are the many members of the Jacobsson family, and especially Violet Jacobsson who has come from Basle for this occasion.

Of course I must think, and do think, that it is most fitting that this Foundation's lectures this year should form part of the festivities marking the 300th Anniversary of the Riksbank. The subject is most apropos to our concerns today. The speakers could not be more qualified. We are delighted and proud to be associated in the activities of this Foundation.

Per Jacobsson, whose name it bears, was born in Sweden and, even if he spent the main part of his life abroad, he was and remained a true son of this country. As he was a many-sided man, there would be many ways of characterizing him. I could easily quote at length from his own writings, or from writings about him. If I abstain from doing that, it is not only to save time. It is really because "Pelle", as we still like to call him, was in a way much too human a man to be pictured in quotations. I know I take a certain risk if I choose to characterize him with just one word, and the risk is not because there is anything wrong with the word. It is simply because only the Swedes present here possibly could understand it. I do hope that Violet Jacobsson and her children and grandchildren here will remember enough of their Swedish to understand the meaning of that single word which I am going to use. Per was, more than any other man I know, a real "Storsvensk". He was in every way, in a wide and broad and generous way, a "Storsvensk", just as his personality in other respects was wide and broad and generous.

I feel no need for any other explanation why we at Riksbank are honored and proud to have the Per Jacobsson lecture in Sweden this year in connection with the celebration of our anniversary. I know that Per, if he had still been alive, would have been with us at our celebration. I welcome the Foundation, the speakers, and this audience, both personally and in the name of the Riksbank. Like the rest of you I look forward with the keenest anticipation to the discussion this afternoon.

OPENING REMARKS

by

W. Randolph Burgess, President
The Per Jacobsson Foundation

Thank you, Governor Åsbrink, for those moving words, and for the tremendous welcome that you have given all of us on this historic occasion. You have made us feel very much at home with the warmth and thoughtfulness of your hospitality.

I wonder if I could take the liberty, as Chairman, of suggesting that we here today would like to see on this platform the four Governors of the Riksbank who are also with us: Ivar Rooth, Mr. Lemne, and Mr. Böök, in addition to yourself? We would like to have a picture of the four of you to mark this occasion. Your presence is a symbol of the extraordinary welcome that we are receiving from the Sveriges Riksbank.

Now, Governor Åsbrink, you have truly said that it is fitting to have the Per Jacobsson lectures here at this time. For the Foundation, by holding its fifth assembly here in Stockholm, is, in a sense, returning home. It was here that Per Jacobsson absorbed those basic principles of integrity, character and thought, and developed that penetrating quest for the true and the humane which made us all love and respect him. Another reason we feel here at home is because of the presence of so many of the Jacobsson family--I think it runs to a total of 20. We certainly welcome them here, and they have welcomed us. Their presence adds a feeling of intimacy and warmth to our meeting.

Also here is my dear friend Marcus Wallenberg, who has been a Director of the Foundation from the day of its birth. His energy and enthusiasm have been contagious. We are happy to have two other of our Directors here--Gabriel Ferras and Pierre-Paul Schweitzer. You may recall that those two have been here in Stockholm only recently on a delicate, important, and successful mission, for the benefit of all central banks, as well as of the IMF.

Now, by way of introduction for the speakers, I want to add one thought to what was said so eloquently yesterday as to the immense value of the tradition of central banking which was launched here 300 years ago. Central banks have indeed been a great steadying power in the tempest-swept flow of peoples' attempts to govern their affairs. But let me venture to add that this success has been due mainly to the fact that central banks are a means by which a succession of dedicated people--and I underline people--detached from political pressure, have been able to modify, smooth and ameliorate the economic life of their countries, and to relate national to international objectives.

I am old enough to have known many of the men who over recent years have stood firmly and insistently, and sometimes very obstinately--as Governor Norman once said, to the point of "nagging"--for those things that are true and right, and for policies that are deeper and broader than purely national ambitious. Of course I think of my old chief, Benjamin Strong in New York, and of Governor Norman in London; of Emile Moreau and Charles Rist, of Hjalmar Schacht, of Luigi Einaudi, and of Maurice Frère. And let me add the names of Camille Gutt, and, most appropriately here, Ivar Rooth, whose devoted service to the IMF paved the way for its later achievements. All of these contributed to building the strength of our Western civilization. And Per Jacobsson was in that line of succession, for the Bank for International Settlements and the International Monetary Fund became banks for central banks. I could go on with that list, but if I should keep on, I would find myself naming many of the people assembled here in this audience who belong on any central bank honor roll. So I will let each of you complete his own list of those who have carried the torch for sound money and the resultant benefits for human welfare.

It is my good fortune today to introduce two men from that honor roll who have rendered conspicuous national and international service as central bankers. They will address themselves to one of the most important and puzzling questions of our generation--and for several generations to come I believe--that is, the harmonizing of the monetary policies of friendly countries as an essential part of the movement towards increased international cooperation. I call on Dr. Holtrop, well known to all of you, whose distinguished career is outlined in your program, and who now, as a retired statesman, can speak his mind freely. We open this platform for him to do so.

CENTRAL BANKING AND ECONOMIC INTEGRATION

Lecture by

M. W. Holtrop
former President, De Nederlandsche Bank

I feel deeply moved and greatly honoured to have been invited to address you on this occasion of Sveriges Riksbank's tercentenary. I am well aware that if there were any person all of us would have wished could speak here today it would have been Per Jacobsson himself, who, as a Swede, would have taken such rightful pride in this illustrious jubilee. As one who as a young central banker, more than twenty years ago, had the great privilege of meeting Per Jacobsson in Basle every month for more than ten years I would not want to begin my address without first paying my warm tribute to the memory of this gifted man from whom I learned so much and to whom this series of lectures is so deservedly dedicated.

I have been asked to talk to you today about central banking and economic integration. On second thought I wonder whether I have not been too rash in accepting this invitation which, at first, seemed so enticing to me. For the more I pondered my subject the more I became conscious of the fact that there exists no unanimity of view on some essential problems of central banking. Also, the impact of economic integration on central banking is still a rather conjectural subject since experience with full integration is lacking. Consequently it is unavoidable that my ruminations shall be of a rather personal character.

With these qualifications I propose to treat my subject by first discussing the objectives, the policy instruments and some of the dilemmas of central banking in the present day world, giving special attention to the differences that exist in these respects between central banks in differently situated countries, and then proceed to the question as to what extent these objectives, policies and dilemmas are likely to be affected by economic integration.

Among the many functions of central banking there are three which I consider of essential importance and which I see as the true determinants of central bank policy, namely:

(1) promoting internal monetary equilibrium, i.e., a condition in which aggregate global demand equates aggregate global supply at a reasonable full employment level and with reasonable stability of the purchasing power of money;

(2) promoting external equilibrium, i.e., promoting a condition of global equilibrium in the balance of payments, in order to protect the exchange parity of the country's currency and to further the stability of the international payments system;

(3) acting as a lender of last resort to the institutions which create money or, more generally, which create liquid financial assets, in order to stave off financial crisis.

Most of the dilemmas of central banking result from the fact that policies favourable to the accomplishment of any of these three tasks may be inimical to the proper fulfilment of any of the two others. To resolve such dilemmas is an essential part of the art of central banking.

Central Banking and Internal Equilibrium

"Money", as I have heard so many times Per Jacobsson quote Walter Bagehot, "money must be managed because it does not manage itself." It needs management because its very use creates the possibility of disturbances in the regular flow of global demand and supply of goods and services. Money being subject to random creation and cancellation, but also to being hoarded or dishoarded, its use implies that aggregate demand may fall short of aggregate supply, or may exceed it. Since any sustained deficiency of aggregate demand will lead to undesirable recessive phenomena, such as underemployment of resources, falling incomes, weakening prices and unsought balance of payments surpluses, while any excess of demand will bring a tendency to almost equally undesirable overemployment, rising incomes and prices and balance of payments deficits, it plainly should be the aim of public policy to try to prevent such shortfalls or excesses of aggregate demand or, at least, to prevent their attaining serious proportions.

This is what I see as the essential internal objective of monetary policy in general. Central banking has to make its main contribution to this objective by its control of the active operations of the banking system.

Money, in our present day world, essentially comes into existence by the extension of credit by the banking system to its private customers or to the public sector, or by other active operations of the banking system, such as the purchase of securities and of foreign exchange.

In this the central bank generally plays but a passive role. It is only when the market is in need of the Bank's own type of money, banknotes, or when it is short of that one asset of which the stock is under the central bank's control, namely foreign exchange, or--under a system of cash requirements--when the banking system has to make deposits with the Bank, that the latter enters into the picture. At that moment the market, through the banking system, will have to offer to the Bank an asset which the Bank deems acceptable. It is at that moment only that the Bank by way of its own operations can exert an influence on the banking system by setting its price for the assets offered, or by making its willingness to deal dependent on the fulfilment of certain conditions.

Assuming the central bank to be in a position of reasonable control over the volume of active operations of the banking system, it is clearly desirable that it should have a concept of at what actual volume of such operations or at what rate of increase in such volume it should be aiming its policies. In a growing economy any rise in national income will be accompanied by a rise in required cash balances and, more generally, by a rising demand for liquid financial assets. If this demand should be met by saving out of current income this might easily result in a drag on the flow of global demand for goods and services, thus preventing potential growth to be realized. In a growth economy internal monetary policy should therefore aim at compensating this foreseeable outfall of global demand. It has to do so by allowing to expand sufficiently to maintain the flow of effective demand at the level of potential supply at reasonably stable prices.

These last words, "at reasonably stable prices", express that, in my opinion, price stability definitely belongs to the primary objectives of monetary and central bank policy. I am aware, however, of other viewpoints which put less emphasis on this point. Governor Rasminsky, for example, in his thought-provoking Per Jacobsson lecture of 1966 denies that the central banker has what he calls a "fixation" with respect to price stability. Yet, he confirms that he and many of his colleagues feel a special responsibility to act as the conscience of the community in this respect. I can follow this point of view in so far that I agree that to actually maintain price stability mostly appears to be beyond the power of central banking. Especially so, because it may come into conflict with the external objectives of monetary policy which often have to prevail. This, however, does not do away with the desirability of formulating a clear objective for internal monetary policy which keeps it within its proper field of preventing or of compensating for disturbances of a monetary character. It is with this objective in mind only that central bank policy can maintain its political neutrality. I would, therefore, hesitate to follow Governor Rasminsky when he says that monetary policy, being part of total public economic policy, its broad objectives must be the same as those of public policy generally. As I see it, the broad objectives of public economic policy reach well beyond the scope of monetary policy and of its limited range of policy-instruments.

These broad objectives do not only include evenly spread full employment to which monetary policy can only contribute by sustaining aggregate demand. They also include a high rate of growth which monetary policy should not impede but can do little to promote, a fair distribution of income to which monetary policy's contribution should be the stabilization of the purchasing power of money and, finally, a wide range of other desiderata to be taken care of by redistribution of the nation's real income but for whose promotion the instruments of monetary policy should not be made available.

It is, in my opinion, very important to thus limit the objective of internal monetary policy and central bank policy to the support of aggregate demand at a reasonably attainable growth level, at stable prices, or, as we shall see presently, at a somewhat lower or higher level as made desirable by considerations of external equilibrium. If monetary policy accepted wider responsibilities it would easily drift into being asked to compensate for the consequences of any mistaken or deficient policies in other fields. If unemployment goes up in the face of wage increases that exceed increases in productivity, or if growth stagnates in the face of insufficient national savings, there is nothing monetary policy can do about it without betraying its primary responsibility towards the maintenance of internal and external equilibrium and towards the defense of monetary stability.

The internal policy objective having been determined central banking must decide how to meet it. Should it allow market forces to take their course and not intervene as long as there are no clear indications that an excess or deficiency of aggregate demand is developing? Or should it plan already in advance for a specific increase in the banking system's active operations?

I believe that the central bank should, indeed, have a quantitative concept of the desirable rate of expansion of these operations and that any important deviation from such a rate should be regarded as a warning signal. But it would not be wise to try to force the banking system to conform to such a planned rate without paying attention to other indicators of possible disequilibrium. I believe that the central bank can roughly calculate the desirable rate of expansion because within the framework of an expected trend of real growth of national income the likely trend of demand for increased holdings of liquid financial assets can be estimated. As a first approximation central banking may plan to allow active operations of the banking system to increase to such an extent as to maintain the existing proportion between liquid financial assets and G.N.P. Then, when the course of the customary indices of economy behaviour, such as industrial production, investment, employment, wages, labour productivity, prices, imports and exports, should show a pattern that is indicative of excessive or deficient demand the central bank may have to decide to lean against the wind and to induce the banking system to expand operations faster or slower than was premeditated.

Central Banking and Fiscal Policy

Central banking is only one part of monetary policy. The other part of it consists of the Government's activity of financing some of its expenditure by creating money and other liquid financial assets or, reversely, by cancelling such liquid assets out of means obtained from current income or from long term borrowing. These activities form part of fiscal policy and debt management. When Government places short term instruments of debt in the hands of the public it provides the economy with liquid financial assets. When it places its short term debt with the banking system it clearly helps to swell the volume of the latter's active operations. The central bank, depending upon circumstances, may or may not be in a position to influence the volume of such Government operations. It is only if and when Government places its instruments of debt with the central bank itself that the responsibility of the latter is clearly involved, whether it is or is not in a position to refuse its accommodation. As we know there are many countries where, for all practical purposes, the central bank is not in that position; there are certainly others where it is. When, henceforth, I shall refer to central bank policy I shall be thinking only of such activities as are actually under central bank control or in which the central bank is at least actively involved. The other monetary activities are Government responsibility.

It must be clear that one can speak of monetary policy as a coherent entity only when the activities of the central bank and the treasury are sufficiently coordinated. If they are not, if Government's monetary activities are exclusively dominated by budgetary considerations without regard for their monetary consequences there may still be a central bank policy but there will be no monetary policy to speak of. Under such circumstances it is unlikely that central bank policy can achieve its aims.

The quantitative impact of Government's monetary activities may easily outweigh the potential influence of central banking. There are, in this respect, important differences between different countries. In the years 1964 to 1966 inclusive, creation of liquid financial assets for the benefit of central Government amounted in the United States to 16 per cent of total internal liquidity creation, in the United Kingdom to 41 per cent, in Germany to only 7 per cent; in France it was negative.

There is no a priori reason why the benefit of profiting from admissible liquidity creation should be withheld from Government. On the contrary, a certain participation of Government may well be necessary to properly take care of the desired asset distribution of the banking system. But it must also be clear that, if Government takes too big a slice, it may become impossible for central banking to squeeze the private sector to such an extent as to still restrain liquidity creation within the limits justified by real growth.

Central Banking and External Equilibrium

The external position of a country has from the central bank point of view two important aspects. In the first place, any deficit poses a problem because it expresses a state of disequilibrium which cannot continue without in the long run endangering the parity of the currency. A limited surplus, on the other hand, is welcome as long as it does not exceed the desired increase in reserve holdings. In the second place, any surplus or deficit acts on the internal economy in the same direction as an internal expansion or contraction of the active operations of the banking system.[1] It has a double impact. It, firstly, increases or reduces the stock of liquid financial assets in the hands of the economy, it, secondly, increases or reduces the liquidity of the banking system itself. These two influences must be well distinguished. The impact on the banking system can easily be compensated in case of deficit since the central bank can always make liquidity available to the banks in order to prevent their having to contract credit. In case of surplus, however, the possibility of absorbing excess liquidity in the banking system may depend upon the availability of an open-market portfolio.

As to the impact of surplus or deficit on the economy itself the central bank has less possibilities since any compensating must be done by increasing or decreasing the volume of operations of the banking system. In case of surplus it would be wellnigh impossible to actually restrain credit in the face of expansionary forces. In case of deficit the Bank may, indeed, overcompensate for the loss of liquidity of the banking system so as to stimulate credit expansion. But it must then have the means to continue financing the external deficit.

Much more effectful in compensating for surplus than the central bank can be Government. By less expenditure or more taxation or by borrowing on the long term market in excess of needs it may, indeed, succeed to withdraw surplus liquidity from the economy. This has actually been done by several European countries.

The impact of external surplus and deficit on the internal monetary position is bound to greatly differ from country to country. The bigger the country the smaller its imports and exports generally are in relation to G.N.P. and the lesser the impact of external imbalance on internal monetary equilibrium. The balance of payments deficit of the United States has since 1960 only rarely exceeded 0.5 per cent of G.N.P. Its deflationary impact was small and easily compensated for. In European countries, however, surpluses and deficits running into several percentages of G.N.P.

1/ We must in this connection think of surplus and deficit in the sense of the external balance of a country, exclusive of the transactions of the banking system. It represents the true balance of foreign transactions of the economy as such.

have repeatedly occurred.[2/] These represent monetary influences which well exceed the maximum impact that can reasonably be expected to ever be exerted by internal monetary policy measures.

The Instruments of Central Bank Policy

The instruments of policy which central banks use to influence the volume of operations of the banking system differ from country to country. This is not only because of differences in the legal powers given to the central banks or to differences in tradition but also because of differences in the intrinsic position of the respective central banks as expressed in their balance sheets.

Legally all central banks have the traditional instruments of discount policy and open-market policy at their disposal. But to use these policies in a restrictive sense is not always possible.

Discount policy can be very effective if and when the market has to make use of the discount window or has to borrow from the Bank by other techniques. It can be a particularly strong weapon of control when the Bank is free to refuse its accommodation and, therefore, also to make this accommodation available under certain conditions only. This offers the opportunity of combining discount policy with rediscount ceilings or with penal rates in case of excessive demands on the Bank. If, however, the market has by tradition an automatic access to the Bank the position of the latter is very weak. In that case the Bank is only left with the possibility of increasing the rate of interest. It is debatable whether this, by itself, is sufficient to exert an important restraining influence. I, personally, do not believe that in conditions of expansion the price of credit will discourage many borrowers. It is less the price than the availability that counts.

In many countries, however, the market is under normal conditions quite independent of the central bank. This is so in all countries where the sum of gold- and foreign exchange reserves, held or financed by the Bank, plus central bank credit to Government, equals the banknote circulation and where, at the same time, the central bank has not the power to prescribe the banking system to hold required reserves with the Bank. In such countries a considerable balance of payments deficit may be needed before the banking system will have to take recourse to the central bank.

If the market is normally not borrowing from the Bank, the latter may yet exert a restraining influence if it disposes of a sufficient open-market portfolio. But again, there are countries which practically have no open-market portfolio available.

We thus see that the powers a central bank can exert by its own normal operations are very much dependent upon the structure of its balance sheet. In this respect we find, even between closely related countries, very important differences. Within the Six, for example, we find that Germany has a banknote circulation of about 6 1/2 per cent of G.N.P. while Belgium has one of almost 20 per cent of G.N.P. France, Italy and the Netherlands find themselves in between. Foreign exchange reserves, held or financed by the

---

2/ I may mention as examples: surpluses in Italy in 1965 of 3 per cent of G.N.P., in the Netherlands in 1952 of 8 per cent, in 1958 of 6 per cent, and deficits in the United Kingdom in 1961 and 1964 of 2 per cent, in Italy in 1963 of 2 1/2 per cent, in the Netherlands in 1956 of 3 per cent.

central bank, also differ greatly. The highest percentage is to be found in Belgium, with over 14 per cent of G.N.P., the lowest, you may be surprised to hear, in France, with less than 7 per cent of G.N.P. The potential importance of required reserves may be illustrated by the fact that while in Germany these run into some 3 per cent of G.N.P., which is comparable with the situation in the U.S.A. (nearly 3 per cent), they amount to almost 6 per cent of G.N.P. in Italy. These data explain how it was possible that in France, at the end of 1967, the central bank could still hold claims on the economy and Government together of around 8 per cent of G.N.P., Italy likewise of some 8 per cent, Germany of some 3 per cent, but the Netherlands practically none.[3/] They also explain a great deal about the differences in technique central banks in the countries of the Six have to use to make their monetary policies effective.

Under these circumstances it is not surprising that the Netherlands were the first country on the Continent to try to regulate credit not by working on the liquidity of the banking system but by giving directives with respect to the admissible percentage increase of loans as compared with an agreed basic period, a system, therefore, of credit rationing.

The desire to exert a certain pressure on the banking system together with the lack of other instruments has led some central banks to even use foreign exchange controls as an instrument of monetary policy. In the Netherlands the direct rationing of bank credit has been accompanied by a refusal to give licences for borrowing from foreign banks. Also, the arrangement that banks shall not have any appreciable net foreign deficit is based on foreign exchange controls.

The Essence of Economic Integration

I do not doubt that, when speaking of "economic integration" all of you, like I myself, are thinking immediately of the type of regional economic integration as represented by the European Economic Community and the European Free Trade Area. More specifically we will probably think of the E.E.C., since it has the broader objectives. The essence of economic unions of the E.E.C. type is the creation of one single market in which there should be no impediment to the free movement of goods and services, capital and persons, and within which no discrimination on the basis of nationality should ever be allowed.

It is well to remember, however, that there exists still another form of integration. It is implied in the membership of the International Monetary Fund, by which countries submit themselves to an international payments system based on fixed rates of exchange, and more specifically in the membership of the group of countries who have declared their currencies convertible in the sense of Article VIII of the Fund Agreement. It is true that this membership does not create a single market since it does not do away with import duties but, in combination with the rules of G.A.T.T., it does create a non-discriminatory area in which the free movement of goods and services and, to a certain extent, also of capital, shall not be impeded by foreign exchange restrictions and quantitative controls without consent of a common authority.

The two forms of integration have in common that participating members are agreed not to use certain instruments of policy for the purpose of influencing financial and trade relations between their countries. By

---

3/ Not including claims on Government due to financing of I.M.F. position.

their nature both are developments in the direction of liberalisation. This means that they both tend to allow free market forces to play a greater role in the relationship between the participating countries than would otherwise have been the case. They both tend to place a greater burden, however, on the few remaining policy instruments. Among these monetary policy and fiscal policy are likely to be the most important.

Economic integration by a common market, which implies the wider field of liberalisation and which includes all the liberties of convertibility, clearly confronts us with the greater problems. Yet, the experience of the past ten years of convertibility has taught us that we have not mastered the consequences of the freedoms which have been established in this narrower field. The lessons of integration by convertibility may therefore not be without some benefit for the integration by common market.

Problems of Adjustment to Integration by Convertibility

The crucial problem that has posed itself under convertibility to both deficit and surplus countries has been the conflict between internal and external objectives of central banking, i.e., the conflict between striving for internal monetary equilibrium and at the same time for external balance.

Such conflict does not exist if and when surplus or deficit are being caused by internal monetary factors, i.e., by an internally generated deficiency or excess of aggregate demand. In that case recession and balance of payments surplus, or on the contrary, boom and external deficit will accompany one another and will need the same medicine, viz., an expansionist central bank policy in the first instance and a restrictive one in the second.

The actual conflict occurs if and when balance of payments deficit or surplus are the consequence of inflation or deflation in the outside world or if they are caused by nonmonetary factors such as shifts in demand or in conditions of supply in international trade, shifts in Government expenditure abroad, be it for military or for aid purposes, or changes in the flow of international capital in response to changing investment opportunities. It is such shifts and changes that affect the conditions of fundamental equilibrium between countries and that should determine, in a world of freely moving exchange rates, the ups and downs of exchange parities. But for various reasons, and especially for promoting the integration between nations, we prefer to live in a system of fixed exchange rates. In this system the equilibrating function of a fluctuating rate is taken over by the much slower equilibrating function of changes in competitive conditions, aided by the buffering function of gold- and foreign exchange reserves. Some equilibrating agent will, however, always be necessary; otherwise payments equilibrium will not be restored and a break becomes unavoidable once reserves get exhausted.

There are only two market forces which in case of external disequilibrium can be expected to work in the long run as equilibrating factors. These are changes in nominal labour cost per unit of product and changes in interest rates. Balance of payments surpluses originating on current account or caused by increases in capital imports destined for local investment tend to boost entrepreneurial profits. They create conditions of overemployment in which wages are apt to rise in excess of increases of productivity. Gradually this will lead to a weakening of the external competitive position and thus helps to restore equilibrium. Reversely, deficits originating in the current account and not caused by internal overexpenditure will tend to reduce entrepreneurial profits. They create conditions of underemployment which favour a lagging of wage increases behind increases in labour productivity. Thus the international competitive position is improved and a return to international equilibrium facilitated.

In the same way the movement of interest rates may under certain circumstances be helpful. If, in a surplus country, imports of capital or an expansive internal monetary policy help to bring interest rates down, this will promote a reduction of inward capital movements or an increase of capital exports. Unfortunately, this is not the most likely development. In booming countries entrepreneurial profits and interest rates naturally tend to go up, not down; in stagnating countries they tend to go down, not up. Capital movements may thus very well behave perversely. If we want to abstain from measures inimical to integration it is, therefore, nominal labour cost per unit of product on whose equilibrating effect we may have to rely mostly whenever fundamental shifts in international demand and supply lead to permanent deficits or surpluses on foreign account.

There is little doubt that the deficit/surplus situation which has existed during most of the last fifteen years between the United States and Continental Europe has been mainly of this non-monetary type. The European surpluses, whether the respective Governments or central banks liked them or not, have certainly not been caused by restrictive monetary policies which brought aggregate internal demand below the level of potential supply. Nor have the United States, except for the last few years, created a situation of excessive demand. What actually did happen was that after Europe, largely thanks to American Marshall aid, had successfully passed--around the early fifties--the period of post-war reconstruction, demand and supply conditions in world trade began shifting in Europe's favour. Moreover, foreign aid, defense responsibilities all over the world, and of late actual war, put the United States under a burden of external expenditure which may not have been too large in proportion to G.N.P. but certainly was too large in proportion to its foreign trade from which the equilibrating contribution would have had to come. Add to this the increased incentive for capital exports created by new investment possibilities in an ever more integrating international community, especially in the emerging European Common Market, and we cannot be surprised that a long period of external disequilibria ensued. This continually placed the central banks before agonizing dilemmas.

In the United States, from the internal point of view, a monetary and fiscal policy had to be followed which should strive for full employment equilibrium at stable prices. Except for the last few years such policies have, generally, been followed with remarkable success. In the years 1958-1965 cost of living went up by an average of less than 1 1/2 per cent a year. But labour productivity improved even a little more, so that labour cost per unit over the period as a whole actually decreased by 3 per cent.

From an external point of view, on the other hand, a more restrictive monetary policy, was indicated. A somewhat lower level of internal demand would have had a direct marginal impact on imports and might have stimulated exports. A less buoyant internal situation might have kept down increases in wages and cost of living, thus helping to achieve a bigger drop in labour cost per unit. And, finally, more Government financing out of capital market resources might have helped to reduce capital exports. Employment and growth, however, would in all likelihood have been unfavourably affected.

Placed before this dilemma, the U.S. monetary authorities have preferred, rightly or wrongly, to shape monetary policies in accordance with internal objectives. While so doing, they have more than fully compensated for the loss of liquidity caused by the external deficit. As a consequence the United States did not materially contribute to a favourable adjustment of that fundamental equilibrating force in international trade: the relative labour cost per unit of product. Including the unfavourable years, 1966 and 1967, during which labour cost per unit went up by 7 per cent, it did not contribute to this aim at all.

Of course, there have been efforts to reduce the deficit. But these were efforts other than those of monetary policy such as the tying of foreign aid, the taxation of certain capital exports and, just recently, the announced new measures in the field of tourist control and of foreign investment. Seen as temporary measures such efforts may help to bridge the time needed for fundamental adjustment. Conceived as permanent measures they would constitute enduring changes in the fundamental supply and demand factors themselves. As such they may very well be effective. But they do represent a shying away from the consequences of international integration. Instead, they are a move towards disintegration.

Continental European central banks had to face at least as frustrating dilemmas. At first, in the early fifties, to find themselves in surplus and able to reconstitute reserves without the pains of restrictive policies was, of course, a rare and pleasant experience. When, however, from 1958 onwards very substantial surpluses on total account started to develop (for the E.E.C. countries in the years 1958 to 1961 an average of 1 1/2 per cent of G.N.P. per year) central banks became more and more concerned about the tendency of wage increases to exceed increases in productivity and of cost of living indices to rise. Consequently, whenever internal conditions seemed to permit such a policy they tended to discourage internal credit expansion in order to fight off internal demand- and price-inflation. Beneficial as these policies may have been for internal equilibrium, they could not but promote external surplus. Nor did they prevent, in the end, wage explosions to occur. Over the entire 9 year period from 1958 through 1966 the E.E.C. countries averaged an increase in wages of 103 per cent, in labour cost per unit of over 33 per cent, and in the cost of living of 35 per cent. Even so, external equilibrium, though gradually approached (average surplus of the E.E.C. countries in 1964-1967 0.7 per cent of G.N.P.) was not achieved.

Could and should different monetary policies have been followed?

The dilemma as it presented itself to the monetary authorities of the surplus countries demanded a choice between three possible lines of action:

(1) They could reduce internal liquidity creation below the standard level so as to compensate for the overflow of liquidity coming from abroad;

(2) they could allow internal liquidity creation to continue as if no surplus existed and have it take care of expected liquidity requirements on the basis of planned growth and stable prices; or

(3) they could allow internal liquidity creation to take care of the full liquidity requirements resulting from expected nominal growth.

The first choice, to reduce internal liquidity creation below standard level, would have meant that monetary authorities would have tried to insulate the internal economy against the consequences of external surplus. It would have been the equivalent of a United States policy of fully compensating for the loss of liquidity caused by external deficit. The consequence of such a policy, if successful, would have been to prevent equilibrating forces to do their work: wages would not have risen more than productivity. The balance of payments surplus, however, would have been perpetuated.

It is this policy which e.g., the Netherlands attempted to follow in the early years of foreign surplus, 1952 to 1954, and again in the period following the recession of 1958, namely the years 1959 to 1961. By perpetuating the surplus and the pressure of outside demand this policy tended to favour the share of entrepreneurial income in G.N.P. as against the share of labour. Consequently it was bound to lead to an ever increasing pressure by labour to restore and improve its share of the cake of national income. In this labour succeeded in the ensuing years. Thus, these were marked by a continual wage inflation.

The second choice, to allow internal liquidity creation to fully take care of normal liquidity demand at stable prices, letting possible foreign surplus take care of the liquidity requirements connected with price increases, was the next aim which monetary policy in the Netherlands pursued. It is a policy which will allow a certain adjustment of the internal cost structure to the exigencies of external equilibrium to take place, but which, at the same time, permits the foreign surplus to continue as a testimony of the still existing state of imbalance in international payments relations.

The third choice, to boost internal liquidity creation to the level required by expected nominal growth, would require monetary policy to concentrate entirely on the elimination of surplus and to ignore internal consequences. It would require the monetary authorities to have a correct estimate of the magnitude of the gap still to be bridged and to purposely permit and even promote internal inflation, just for the sake of eliminating surplus.

I do not think this latter policy is one that any monetary authority would care to choose freely. Yet, it is a policy that may very well be forced upon it if and when an all too long continuing surplus gradually has numbed the sense of financial responsibility and has led to a permissive attitude towards both excessive Government deficit financing and wage inflation. When these occur without leading to actual foreign deficit and when wage inflation is rationalized by calling it adjustment to foreign disequilibrium the position of the central bank as the advocate of moderation and prudence internally and of the discipline of the balance of payments externally becomes very weak.

The fateful choices monetary authorities, whether in deficit or surplus countries, have to make are their own sovereign responsibility. There is no international authority that can decide for them. The International Monetary Fund could conceivably give an opinion. It could even support such opinions by refusing its facilities to uncooperative debtor countries or by declaring the currencies of uncooperative creditor countries to be scarce. But sovereign nations have the right to their own opinions as long as they are able to deal with the consequences. Moreover it is doubtful that there is sufficient agreement on basic monetary philosophy to allow the Fund to arrive at a consensus of opinion on such controversial points of policy.

Meanwhile international monetary cooperation has done its utmost to prevent the described dilemmas from rupturing the international monetary system. Surplus countries have intensively cooperated to bridge the payments gap by many forms of special monetary financing. Yet, the problem of how to restore payments equilibrium in the face of strong disequilibrating forces remains with us.

We shall now see how this same problem poses itself in an economically integrated community of nations both within the community as well as in the relation of the community to the rest of the world.

Central Banking in a Common Market

The primary objectives of central banking in an economically integrated community are, in my opinion, no different from the objectives under convertibility. Central banking will still be responsible for the promotion of internal equilibrium in its own particular country and thus have to counteract internal inflationary and deflationary tendencies. At the same time it will have to promote its country's external equilibrium for which purpose it may have to compromise on its first objective.

Some may think that in an economically integrated community of nations these national policy objectives should be abandoned and that the central banks should become jointly responsible for internal equilibrium within the community as a whole and for external equilibrium as one body in relation to the rest of the world. But this cannot be so as long as economically integrated communities still consist of sovereign nations with different standards of wealth and different national, social and political objectives, who decide unilaterally on Government expenditure and taxation and who do not abandon that one essential attribute of their financial sovereignty: the power to inflate their own currencies by excessive short-term financing of expenditure. In the integrated communities of the present none of these sovereign freedoms have been brought under supra-national control and no evolution in that direction is to be expected in the foreseeable future.

Under these circumstances it is essential that every member-country of an integrated community, as a check on its financial policies, remains responsible for its balance of payments and, ultimately, for the maintenance of its exchange parity.

This fact alone already implies that, as yet, there cannot be one uniform central bank policy for the community as a whole. Depending upon the external position of their various countries central banks may have to follow different lines of action, more restrictive in one, more expansionist in the other, so as to support the more fundamental forces of adjustment.

These fundamental forces are no different from those that operate in a convertible world: relative nominal wage cost per unit of product which ultimately controls trade and relative rates of interest, respectively rates of profit, which ultimately control capital movements.

Not only external but also internal conditions may cause central banks in an integrated community to follow diverging policies.

As we have already seen, the part of total admissible liquidity creation which Government desires to make use of for its own financing may widely differ from country to country as well as from year to year. Central bank policy, in determining the admissible volume of liquidity creation for the benefit of the private sector, will have to take the demands of the public sector into consideration. This may lead to more restrictive credit policies in one country, to more lenient ones in another.

Moreover, as experience in the European Economic Community has shown, the course of the business cycles in the member countries may not run parallel. Time lags between the beginning and the end of individual cycles in member countries of three quarters of a year to over two years have been observed.4/ Leaving aside the question whether such differences were possibly partly due to differences in monetary and other policies themselves, it is clear that if and when significant divergences in cyclical evolution do occur central bank policy has to react to the specific local conditions. This again may mean divergence of policy.

Further, even where policy indications would be identical we have to face the differences in the available policy instruments. While in a country like France a favourable proportional relationship between banknotes and foreign exchange reserves and in a country like Italy high reserve requirements have created a situation in which the central bank has a strong grip on the market, we find that in a country like Germany this grip is relatively weak and in the Netherlands practically non-existent. Consequently the techniques for putting restraining pressures on the banking system will have to vary considerably.

For all these reasons one uniform central bank policy for all the member countries of the type of economically integrated community we know at present is not possible. While the ultimate objectives of central bank policy should be the same and while it is highly desirable to be agreed upon general strategy the tactical measures to implement this strategy may have to be different and will have to be adjusted to local circumstances.

In this field of tactical measures one should include the protection of central bank policy against influences which could possibly thwart it. Already under convertibility such influences have played an important role, to wit in the development of the Euro-dollar market in which national private banking systems have found such an easy supply of additional funds.

It is often not sufficiently understood that this market is part of an inflationary mechanism through which the excess liquidity of countries in balance of payments surplus is passed on to countries in equilibrium or in deficit. This is done either by private banking systems which cannot use their surplus liquidity at home since they no longer have any debts to pay to their central banks or by monetary authorities themselves who are enticed by high yields to invest part of their foreign exchange reserves in that market. In the recipient countries these funds serve as an extension of the banking system's internal lending capacity or are used as a basis for expanding international bank-to-client operations.

If Euro-market funds are being used by the banking system for the extension of local banking operations central banks can protect their policies. Like Italy and the Netherlands have done they can limit the banking system's net foreign indebtedness. Or they can, as Germany did, stipulate that foreign lending by the banks be deducted from internal discount facilities. Or they can establish credit ceilings in order to prevent increased bank liquidity to lead to credit expansion. More difficult is it to protect central bank policies against the internationalisation of bank-to-client operations. Only the Netherlands, I believe, have taken the step to forbid as a logical extension of their internal credit restrictions any borrowing by private industry from foreign banks.

4/ Drs. H. R. Wortmann, "Conjunctuurcycli in de E.E.G. landen", *Economie*, January 1968.

It is to be expected that, in an integrated economic community, there will be a tendency for leaks in the control by central banking to become more rather than less important. Private banks will naturally tend to come to ever closer forms of communal cooperation. Already now we can observe within the E.E.C., and partly extending beyond its borders, the formation of groupings of the more important banks for the purpose of cooperating in certain fields. We also see the emergence of international banking institutions, created by groups of banks for the purpose of taking care of certain types of specialized business. It would be easy for such cooperating banks to pass from one to the other any temporary surplus of liquidity or to arrange for temporary transfers of loans made to big customers.

Central banks within a community will have to give serious attention to these problems and must find means to prevent these kinds of transactions interfering seriously with the effectiveness of their monetary policies. Once the principle of central bank control of the volume of active operations of the banking system is accepted it must be clear that such control, in an integrated community, should not stop at the border of the separate member countries. If it did effective control might well be made impossible by across-the-border banking.

Central banks in an integrated community must, therefore, be able to support one another's policies. For this purpose it is necessary that they should have as effective powers of control over the volume of operations of their banking systems in other community countries as they have over local operations.

In asking for and making use of such powers central banks may well find themselves up against the protagonists of "liberty" within the community. They will tend to interpret any constraint of intercommunal liberty of action of the national banking systems as a limitation of the desirable freedom of capital movements. It must be understood, however, that the concept of liberty can never hold for the creation of money. Also, the movement of funds from one banking system to another, and the active operations of banks in foreign markets have little to do with the desirable, most favourable distribution of the supply of long term savings among the available investment opportunities in a community. These banking activities are but techniques by which, under a system of fixed exchange rates, excess liquidity can be shifted from one country to another, forcing central banks against their better judgment to create local currency against an undesired supply of foreign currencies.

Supporting one another's local policies would be facilitated if central banks could and would use similar techniques of restraint. However, as we have seen, differences in the position of central banks often necessitate the choice of dissimilar instruments of policy. If these differences find their origin in an insufficiency of legal powers it is, of course, desirable that such powers shall be broadened. I consider it, for example, essential that all central banks in a community should have the power to introduce adjustable reserve requirements, applicable to all liquidity creating institutions.

The tactical measures of central banking in an integrated community can largely be left to the individual central banks provided that the choice of instruments is such that it does not interfere with the policies of the other banks of the community. This is not so with respect to the strategy of central banking.

If the strategy of monetary policy within a community is not coordinated, if the members are not agreed on how to react to specific situations of external disequilibrium, either of a single member or of the community as a whole, serious difficulties are bound to arise.

This is especially so if the community as a body finds itself in persistent balance of payments surplus. At such a time a common strategy is essential since otherwise situations of fundamental disequilibrium within the community are almost certain to ensue. As we have seen earlier, countries facing such a persistent surplus situation have to choose between three policy alternatives, viz., (1) to aim monetary policy at compensating for the inflationary impact of the external surplus; (2) to continue monetary policy as if there were no surplus; or (3) to promote an internal oversupply of liquidity.

It must be clear that if the members of an integrated community should make dissimilar choices among these alternatives the competitive relationships within the community would be severely disturbed. Those members opting for the first alternative would see their surpluses continued or even enhanced while their competitiveness within the community would be increased. Those who would opt for the third alternative would, on the contrary, be likely to see their surpluses quickly disappear and their competitiveness deteriorate.

In the first six years of the European Economic Community member-countries did not align their policies in respect to these three alternatives, nor were their policies always consistent country by country. Adjustment to foreign surplus took, therefore, an irregular course. It is not without significance that the two countries who in these early years most consistently followed the first alternative, namely the policy of compensation, were also the countries who found it desirable to revalue their currencies in 1961. Had the other countries of the Six followed the same compensatory policy a general revaluation might have been the logical and more desirable outcome.

In the years 1964 to 1966 monetary policies of the Six have tended to converge. All of them allowed internal liquidity creation to exceed foreseeable liquidity requirements at constant prices, all of them suffered from the cost- and price inflation which necessarily accompanies this policy. External surplus in this period tended to go down but, for the Six as one body, did not disappear.

Similar problems of having to decide on policy alternatives may pose themselves if the community as a whole is substantially in equilibrium with the outside world but persistent debtor or creditor positions show up with individual members. Such positions will not appear as surpluses or deficits in relation to the other members of the community but as positions of external imbalance generally. They do not, therefore, first and foremost present themselves as a community problem but rather as a matter which must be solved by the respective members.

However, the community would be involved if the deficits were due to a debtor's persistent inflationary, or the surplus due to a creditor's persistent deflationary policies. Because it would be the members of the community who would be likely to suffer most from the consequences of such policies. In such cases the recipe for a return to equilibrium would, generally, be simple enough and should not give rise to much controversy.

More difficult to agree upon would be the policy measures required by surpluses or deficits which would be caused by fundamental changes in demand and supply conditions in international trade, by long term capital movements and by major changes in Governments' expenditures abroad. Mutual policies must then allow wage cost relationships and/or interest rates to adjust themselves to the new situation. The big question is what standards will then have to prevail.

Should the debtor countries in the community a priori be allowed to maintain nominal wage cost per unit of product and should surplus countries, therefore, be expected to inflate until equilibrium has been reestablished? Clearly, the answer is no. Generally, both sides should contribute to the restoration of equilibrium. But how much of the adjustment will have to come from one side and how much from the other may well depend upon the merits of the case and upon the strength of the community's position in relation to the rest of the world.

In the European Economic Community two bodies have been created to promote the coordination of monetary and central bank policies. There is the Monetary Committee in which Governments, central banks and the European Commission are all represented and in which monetary and economic policies of the member countries are very frankly discussed and examined. There is also the Committee of the Governors of the central banks in which central bank policies are regularly reviewed with a member of the European Commission participating.

Both these committees are helping to reach a better understanding of one another's policies and policy instruments and to approach a common philosophy on what monetary policy generally and central bank policy in particular should accomplish. But I would be too bold to say that the participants are already speaking a common language. There are certainly points of analytical detail, of formulation of objectives and of evaluation of policy measures on which different opinions are being held. Some stress the importance of the liquidity of the banking system, others of the liquidity in the hands of the public. Some prefer, others rather distrust quantitative methods of approach to monetary problems. And, finally, there are those who are inclined to emphasize and those who rather minimize the importance of maintaining price stability. However this does not detract from the fact that we have in the Community of the Six been fortunate enough to find both Governments and central banks united in the conviction that a positive monetary and central bank policy has to play a vital role in promoting and maintaining internal and external equilibrium. This conviction is not weakened by the full recognition that success in the one field may be unattainable without some sacrifice in the other.

In concluding I would like to stress again that central banking in an integrated community is not going to be essentially different from central banking under convertibility. It will continue to be confronted with the problems of compromise between the search for internal and external equilibrium. If anything, the dilemmas are going to be more acute, since the external factors are bound to become of greater relative importance and non-monetary controls less available. As a result considerations of internal equilibrium will have to yield still more to those of external equilibrium.

Local central bank policies within an integrated community may have to be dissimilar, both in regard to immediate objectives and to instruments used. General objectives of monetary policy within an integrated community must, however, be the same and it is essential that a great measure of agreement on the interpretation of these general objectives be achieved.

Continuous consultation between the members of a community is necessary to help avoid the pursuit of internal monetary policies which could lead to major external surpluses or deficits. Persistent deficit and surplus positions within an integrated community will be just as intolerable as under convertibility, or even more so because there will be less opportunity to overcome them by direct controls.

Common policies will have to be agreed upon with respect to the adjustment of a community to collective positions of surplus or deficit in relation to the rest of the world. This is especially desirable in case of a position of surplus since there is then a much wider range of options available to individual countries than in the case of deficit. Lack of agreement in this area could, in the long run, endanger the maintenance of exchange parities within the community. Rather than to drift in that direction an integrated community will have to muster the imagination and the courage to conceive and pursue a common monetary strategy. Such strategy must offer a reasonable compromise between possible conflicting demands of internal and external equilibrium. It should not make a fetish out of price stability, nor should it be based, however, on accepting persistent cost-or price inflation as the condition for avoiding payments surplus.

Reaching agreement between sovereign nations on the ultimate objectives to be pursued in monetary matters and on the strategy to be followed is not going to be easy. It will be a challenging mandate for central banking in an integrated community to contribute to the achievement of this aim by extending and deepening that close cooperation between central banks which has already played such an important role in the past and to which the man we are honouring today, Per Jacobsson, dedicated so large a part of his life.

* * * * * * * * * * *

MR. BURGESS: Thank you, Dr. Holtrop, for that searching analysis, which leads us to the old-fashioned conclusion that there is no fairy godmother who will bring up a coach to take us away from our struggles, but that the methods that we have been trying out over the years have still to be continued.

I remind you that this speech will be published in a number of different languages and will be available for analysis so that, as I hope, many people can give their reactions to it.

Now we go on with our theme, and we have as our next speaker another great central banker, who spent six years with the Bank of England, as Governor. His family involvement in banking goes back over several generations. He also is free to give us his interpretation of events that he has lived through. I introduce the Earl of Cromer.

CENTRAL BANKING AND ECONOMIC INTEGRATION

Commentary by

The Earl of Cromer, P.C., M.B.E.
Managing Director, Baring Brothers & Co., Ltd.

It is always a pleasure to listen as we have just done to one who is a master of his subject, calling on all the resources of many years of practical and theoretical experience. By the same token it makes the task more difficult for whoever is called upon to deliver on the same occasion the second Jacobsson Memorial Lecture.

I am indeed deeply honoured at being invited to deliver this lecture today, particularly as it takes place in Sweden, the birthplace of Per Jacobsson, and in conjunction with the third centenary of the Riksbank. As a merchant banker with only just over two hundred years of merchant banking to call upon, I would like to convey my congratulations to the Sveriges Riksbank, and, as my talk develops, you may notice that perhaps my merchant banking blood shows up rather more than my central banking blood, insofar as there is some difference on some matters--but not many--with Dr. Holtrop. I approach this lecture, I may say, with considerable humility and diffidence. But it provides me with the opportunity to pay my tribute to a true friend and a very remarkable man who dedicated his life to seeking a better world for mankind, in general based upon a monetary system in which mankind could have confidence and could prosper. Per Jacobsson was a wise man and a good man and a kindly man, with a sense of vision, tempered by tolerance of the foibles of mankind. It is the forwardlooking element in his character that I would principally like to evoke today in the theme of my lecture and I trust that what I have to say today would have commanded his support.

Central Banking and Economic Integration, as Dr. Holtrop said, is still a conjectural subject in which experience is limited and achievements so far modest in their results. Indeed it is open to question whether the kind of inter-central bank cooperation that we have seen of recent years has not to an extent been taken advantage of by governments to defer the pursuit of more appropriate over-all monetary and fiscal policies. Rather than elaborate on the points made by Dr. Holtrop--and elaboration is certainly not called for after such lucid treatment--I have decided to pursue today a rather more philosophical approach to our subject, for we are, in my belief, at a point in time where serious appraisal of the world monetary system is called for. There are in the present state of affairs elements of instability which call for remedy if the international payment system is to avoid jeopardy. And in the last few years it has been disturbing to observe a widening divergence between the thinking in governmental circles on the one hand, and the thinking of industrialists, bankers and leaders in technological development on the other hand. I would like to attempt to elucidate what I mean.

The year by year growth in international trade and the prosperity of all dependent on such trade owes much to the International Monetary Fund and its efforts to eliminate the restrictions on current payments which were the heritage of the long years of war, and to the GATT, which can likewise claim credit for its success in reducing the tariff protection, as it was called, the heritage of international trade stagnation of the thirties when it was still believed that modern industrial economies could be self-contained. In the immediate aftermath of the war few, if any, believed that the world faced two decades and more of growing prosperity. That this has indeed been the case is due partly to the action of government and partly to the increased liberalisation of payments and trade which has allowed the private sector to contribute with full effect. Indeed, when Per Jacobsson attained what was perhaps his crowning success, the adoption of external convertibility by the leading European powers in 1958, bringing them into line with the other powers which enjoyed this freedom to prosper, all seemed to bode well for continuing progress in freedom of payments, including capital payments, and for the prosperity which went with this.

Today there are too many signs of regression from these aims of growing freedom linked with growing prosperity--not because this course has been found to be wrong, but because the United States and the United Kingdom, who happen to be possessed of the only really international trading and reserve currencies, quite separately and in different degree and direction, have followed policies which, if perpetuated, may well jeopardise, not only future progress, but progress already made. Indeed, both the United States and the United Kingdom today are following policies which progressively threaten the very liberalisation which has supported the growth in world trade in the post-war era. Recent years have seen increasing regulation and restriction of international payments imposed by the United Kingdom, so that the resident of the United Kingdom is today more restricted in these fields than the inhabitants of any other major industrial country. I want to stress the measure and significance of this regression. The United Kingdom which has been dependent for her living and prosperity on freedom of use of money for more than a century and a half--the United Kingdom which has consistently relied on her invisible balance, having only in five years since 1796 achieved a trade surplus--that same United Kingdom today makes it a criminal offence to take outside the Sterling Area more than £50 (equivalent to $120) in foreign exchange, without official permission; normal capital transactions have been reduced to a trickle; and some $250 million of privately-owned capital seems last year to have been diverted to the official reserves where they were dissipated in official market support. The United States, whilst refraining from the use of the words, exchange control, is, in fact, introducing measures to achieve a like result, although the United States balance of payments deficit since 1960 has rarely exceeded 0.5 per cent of GNP. Let us not forget that from one control grows the next control; discrimination leads to further discrimination, and mistrust feeds on mistrust. To retreat from liberalisation in international payments because of unwillingness to pursue an appropriate domestic mix of fiscal and monetary policy, and to continue to create money, as is the case in the United Kingdom, regardless of the relation of this new money to production, is to move inevitably back to the unsuccessful efforts of nation states during the inter-war years to find economic prosperity on an exclusive basis within national frontiers. Such policies would have even less chance of success today (even if success is regarded as no more than the mere avoidance of collapse) than they had then, for there is now an important new factor, or rather, a factor which has acquired much larger proportions; and this new factor arises, unfortunately, in an area where I discern disturbing divergence in thinking between government and the world of business and technology.

This new factor is the much greater interdependence of national economies in general, and, in particular, the growth of international production with components or complete units of some greater whole being produced in different countries. Although the data is far from complete--but then balance of payments statistics are seldom more than an approximation, despite the hallowed respect they frequently receive to the last questionable decimal point--it is estimated that the growth of this kind of international production is running at a rate today of some 27 per cent per annum compared with an export growth of 11 per cent. Furthermore, as modern technology of production becomes increasingly sophisticated, the capital intensiveness of the individual industrial plant will increase, with the result that individual countries will not provide a sufficient market for the output of such plants, nor, for that matter, will the individual capital markets of the individual countries suffice to finance every particular plant. It follows from this that freedom of capital movements over frontiers will be essential if these plants are to come into being, that freedom of payments will be necessary in servicing investments across frontiers. Freedom of movement of goods across national frontiers and of the payment therefor will also be necessary in this new world of interdependent economic structures. I have no doubt in my mind that this kind of industrial development is evolving now and will become more and more the pattern of the future. These are the horizons which the industrialist, the banker and the technologist have their eyes on. Governments that fail to recognise this inexorable development and deny their people, through exchange controls or fiscal discrimination, the opportunity to participate in this new world, will find their country lagging behind in technological development and their brighter citizens attracted to greener fields. In contemplating the future of Central Banking and Economic Integration, it is essential to take these factors into account over and beyond the present aims of central banking cooperation. Equally, it is essential that governments allow for these developments when they look into the components of their balance of payments and try to economise on them by direct controls.

Confidence in money is essential to continuing and enduring prosperity in the modern industrialised state. With future development dependent on prospective capital investment, it is all-important to maintain a climate propitious to saving since without savings the wherewithal will not be created to support the necessary investment. As Per Jacobsson himself said, "... no lasting contribution to investment can be achieved by means of inflation, even if a country were willing to tread this path".[5] To what extent inflation or the declining purchasing power of money, which are the same thing, can be tolerated is not a subject that I intend to debate today. But there can be no doubt that continuous inflation is corrosive of confidence in money and ultimately of investment. There is, however, no balking the fact that the continuing magnitude of the United States deficit and the forced devaluation of sterling last November has shaken confidence in money in many places.

We are now living in the aftermath of the latter event. It will, I fear, be a long time before the world recovers from it. It was a traumatic event, coming as it did, not as the outcome of any international holocaust, but after many years of high world prosperity. It has been described by a good friend of Britain, conservative in his use of words, as repudiation; and in other countries where language usage is perhaps cruder and less refined the nicety of the difference between devaluation and default in the case of a trading and reserve currency is not always at all finely drawn. Whether such harsh words are justified, the event was very much more than a

5/ *International Monetary Problems, 1957-1963:* Selected Speeches of Per Jacobsson (Washington, International Monetary Fund, 1964), p. 119.

mere technical adjustment, as some economists tended to suggest would be the case. Many age-old trading patterns have been disrupted, and those with responsibility to their own people in their own countries for the wide administration of national reserves have been given deep anxiety as how to best fulfil their responsibilities. It was inevitable too that, in the aftermath, acute problems would arise in the international gold market--problems which, to my mind, have been wisely and prudently handled up to the present.

It was, of course, the hope of all of good will that after the devaluation of sterling matters would settle down; that all the restrictive measures which had been invoked to support the old parity, but which had such serious adverse effects on the international use of sterling by United Kingdom residents, would be rescinded as no longer necessary to support the new parity, and that gradually confidence would grow, as Britons once again joined on an equal basis with other nations in the liberal world of international payments which, as I have said, has achieved so much to widen the spread of prosperity in the post-war years. But government expenditure this current year in the United Kingdom is nonetheless to be higher than last year. Some five months after devaluation, steep increases in taxation were therefore introduced, some even confiscatory, particularly insofar as they affected entrepreneurs. To give an illustration of the severity of the measures, the entrepreneur and others are being called to pay a tax of 135 per cent on last year's investment income of £9,000 or over. Earned income already attracts tax of 91 per cent at a level of £15,000. But there were also substantial increases in indirect taxation which, together with the spreading effects of devaluation, are forcing prices up over a wide range. Notwithstanding this, the over-all demand for goods appears to have been increasing over recent months, but future level of demand will be influenced by the prices and incomes policy which, if it is to succeed, has the difficult task of permitting internal prices to rise whilst preventing purchasing power from keeping pace. The exceptional strength of the stock market would also indicate a preference for assets in the form of equities rather than money stocks; and the appetite for international investments expressed in foreign currency shows the same tendencies. These are all facts of public record and familiar to all in the international world of finance who follow the developments of United Kingdom economic policies.

Being coupled with an atmosphere of continuing uncertainty, all of this adds up to a situation of some vulnerability. Against the background of the United Kingdom's owned reserve position, with the best will in the world, and with every possible effort being made and sound financial policies being followed, it is bound to take time to bring affairs into a satisfactory state. These problems will not be solved by closing our eyes and pretending that they do not exist.

This situation exists at a time when central bank cooperation has already reached an all time high in volume and sophistication. I have first-hand experience of what is possible in this field. But I also have a pretty clear understanding of the fact that, if such cooperation is abused by diversion from its intended purposes, the end result may be worse than if there had been no such cooperation. Let us be quite clear that central banking cooperation has never had as one of its objectives the provision of unlimited finance to cover a continuing over-all deficit by any country. It provides a civilised and sophisticated means of handling the effects of the short-term movement of funds which, in normal expectation, will reverse. It also provides valuable support in the provision of time for governments to react to changes in circumstances which, for one reason or another, have not been foreseen, or have arisen so quickly that time is needed to institute appropriate policies. But beyond this it does not go, nor should it be expected to go. If we want central banking cooperation to go further it has to go a great deal further and on this I will have a few words to say anon.

In this present situation of malaise there is much of common international interest. If any widely used international currency were, in the foreseeable future, to come again under pressure which caused another devaluation, the consequences could be serious indeed. All the bright hopes for the future could wilt and we would be faced with a bleak and uninviting prospect of no short duration. Such is the integration of trade, finance and commerce today between countries, that no one country by itself, however strong its own currency, will remain unaffected. We have a common interest in preventing this occurring, we have a common interest in future prosperity, and we have a common interest in the continuation of the effective working of the international market economy of the Western world as a whole.

As Dr. Holtrop has pointed out, apart from "the basic determinants of central bank policy", as he describes them, "the fateful choices monetary authorities have to make are their own sovereign responsibility", and he went on to say that "sovereign nations have the right to their own opinions as long as they are able to deal with the consequences". But what if the consequences have direct and dire effects on others? If the points I have made earlier about existing and future integration between the private sectors in the different countries are valid, has not the time come when, as a matter of some urgency, thought should be given in the central banking world to some form of counterpart in their own field? The price of the benefits that mankind enjoys, and will enjoy at an accelerating pace, is the surrender of some national sovereignty to some international patterns of behaviour. This is the price of progress, and the backwoodsman who opts not to pay it will find himself becoming an out-dated relic in a civilisation that has passed him by.

If we are to see increasing prosperity soundly based--which I much prefer to the word "growth", now so completely discredited--if we are to approach the horizons which I referred to earlier as being before the eyes of businessmen, bankers and scientists, it is paramount that there should be complete confidence in money. Primitive though it may be, I do not believe that mankind is yet sufficiently impressed with the wisdom and ability of governments for people to feel this complete confidence in money if governments have *carte blanche* in the creation of it. I do not mean by this that we must return to the fundamental gold system of yesteryear; indeed, I would not be averse to the evolution of a system which led to the eventual demonetisation of gold. But it would be necessary, before any such action is taken, for mankind to be satisfied with the continuing integrity and viability of any new system, and this new system has to be built up from the low point in confidence that unfortunately, but inescapably, exists today.

Despite the difficulties that can be seen, as Dr. Holtrop has very properly pointed out, in the sovereign interests of nations, I would nonetheless like to make a suggestion--a *ballon d'essai* if you like--for consideration by experts. My suggestion is in the nature of a concept rather than a blueprint. I would suggest the setting up of a European Monetary Board to which should be party all those European nations who see it in their interests to ensure future confidence in money and the monetary system. I would envisage that this European Monetary Board should carry sufficient authority with member countries to ensure that no one of them should follow monetary and financial policies which would jeopardise the sound working of the whole system.

Let me say at once that I am not envisaging a super central bank with new funds and power to intervene in open market operations in the markets of its members. Neither am I proposing yet another intergovernmental institution to trespass on the broader economic grounds which is already well covered by Working Party Three of the O.E.C.D.; nor yet do I want to detract from the work of the B.I.S. or the Fund in their different areas. What I have in mind is something different from all those bodies, namely a small Board of men of standing who would be appointed for a term of years (perhaps on a similar basis to the Governors of the United States Federal Reserve Board) and who, once appointed, would be irremovable for their term of office and would take their decisions in their own right and not as the delegates or appointees of any country or government. This I would regard as essential. The duty laid on them would be to draw to the attention of a member any monetary or fiscal development in his country which, in their view, was endangering, or likely to endanger, the stability of the member's money or of public confidence in it. For this purpose they might make confidential reports to the individual monetary authority concerned, but they would also have the power to make a confidential report on any one member to all members of the group. The Board would have no powers to prevent any member following any policy that member wished. But, if the Board had counselled a member and had then proceeded to make a report to all members of the group, the other members, having had timely notice of developing events, would be in a better position to exercise their judgment if they were subsequently asked to grant, or to contribute to, credits in aid of that member. The main benefit I would hope for, however, would be that the continuous and intimate exchanges of facts and views between the Board and the individual national monetary authorities would prevent things from often reaching that point. In order to carry out this duty satisfactorily, the Board would have to have all the returns and figures which each central bank supplies to its own governors and Treasury day by day. I know this is asking a lot, but I do not believe that the duty placed on the Board could be discharged without it. The aim would be to establish complete confidence between the Board and the individual national monetary authorities, by which, as ever, I mean to cover both Finance Ministries and Central Banks.

In venturing to suggest a European Monetary Board, as opposed to some institution of a wider membership, including the United States, I am influenced by a number of considerations. First, that the new organisation should be manageable and effective; the wider the basis the greater difficulty. Second, the developments which I envisage in Europe may not necessarily be compatible with United States domestic and international responsibilities as seen by the United States Congress. You may also be wondering why I am not content to entrust these new duties to one of the well-tried and proven international institutions already in existence. A moment or two ago I disclaimed any intention of wishing to trespass on their grounds. Let me now explain why I think that a new and separate body is required. My first reason I have touched on above: if this proposed Monetary Board is to be effective, it must have a precise duty, certainly not ranging over the whole field of politics and economics--though it must not, of course, ignore those wider fields--and its duties must be concerned with a limited number of countries having broadly similar economies and broadly congruent interests. This function is different from that of the great international institutions, and I would think it improper to attempt to insert it, as a special and regional element, within such an institution. These established international agencies have their own very important domains--but their purpose is different from what I am proposing.

This brings me to my second reason for not trying to insert the new proposed Monetary Board into one or other of the international institutions.

I have learned from experience that the Executive Directors of the International Monetary Fund are inevitably delegates of the countries which they represent and, on any important issues, have to represent positions which are ultimately political. In the final analysis, on any major issue it tends to be the political grouping which decides the issue--although it is only fair to state quite clearly that, at other times, when major issues are not at stake, much valuable interchange of thinking does take place. Having also attended many meetings of the Bank for International Settlements in Basle, where the central bank governors are present as what one might describe as principals in their own field, as opposed to delegates, I know that the difference between a Basle meeting and a Fund meeting is in this respect considerable. In my present suggestion, as I have already said, I go still further in proposing something like an assured international freehold for the Board members during their terms of office, to ensure that their decisions shall be free from the national pressures under which any national delegate must work--and indeed should work--when he is discharging a national delegate's duties. I do not question that today the Fund must, in the nature of things, be directed by a Board of delegates, but the evidence of the facts is that this has not always enabled it to exercise sufficient surveillance or sufficient influence over sovereign national governments, particularly in the case of the major countries. Despite its not inconsiderable powers of sanction, the Fund has been unable, in such cases, to insist to the point of effectiveness. The situation which led to the devaluation of sterling did not arise overnight. The failure of the Fund to react publicly when the United Kingdom first derogated from the obligations of Article VIII and its failure again when this derogation was extended for a further year, convinces me that a worldwide, delegate-directed institution is not appropriate for the function that I have in mind in the European Monetary Board. The Fund is indispensable in the wider international monetary field, but is something different from what I am proposing to you.

In putting forward these ideas, very tentatively, I realise that there will be some who will regard such proposals as impracticable, and others who may well be hostile to any subordination of national state freedom in the monetary field. There will certainly be those who question what an international Board could do that the individual central banks cannot already do. Central banks are generally considered to be charged with the integrity of the currency, and their origins are not unconnected in past history with abuses by irresponsible rulers who debased the currency, permitted clipping of the coinage, or made excessive resort to the printing press. It has, however, to be recognised that, in varying degrees in different countries, the autocracy of the state, less easily identifiable as the culprit than the individual despot of history, has found ways through the years, often under justification of wartime exigencies but never subsequently rescinded, to circumvent such safeguards against similar abuses.

You may perhaps think that, in comparison with the task I propose for it, the Monetary Board would be a rather modest affair. I believe beginnings should be modest. When Robert Marjolin was serving as a high official of the European Economic Community, he produced, a year or two ago, a proposal for a European monetary unit. At the time he came forward with this suggestion, I, in common with many others, felt it was premature and that this was more likely to come about as a culmination of European unity after harmonisation of fiscal and monetary policy. Since that time the deterioration in the stability of the whole system, brought about in part by the weakness of sterling, leads one at least to look at this question again. The concept of a European Central Bank and a European currency could offer many attractive possibilities. Under international control, it could provide Europe and the world with a very strong and well-equipped international currency, and indeed provide an improvement under European auspices on the Euro-dollar both as a banking and a capital currency. But all this, if it ever came about, would be for the future and would depend on the success of small beginnings.

It may be that the thoughts that I have expressed here today will be as so much chaff before the wind. But if, as I hope, they stimulate others to bestir themselves to meet the challenge that faces us today, I will feel that I have been true to the traditions that Per Jacobsson has left us. He believed, as I do, that it is the small saver who is most hard hit by inflation and devaluation. He pointed out that price increases of between 2 and 3 per cent a year will reduce the purchasing power of savings by one quarter in ten years. He was tireless in his efforts in the world of monetary affairs to bring about conditions of monetary stability in which mankind could prosper, safe in his trust of the integrity of money. This integrity today is under threat. Let us rise to meet the challenge whilst there is still time to do so.

* * * * * * * * * * *

MR. BURGESS: Thank you, Lord Cromer, for again bringing us vividly face to face with the problems that are before us. And thank you also for suggesting to us a definite line of progress. It certainly is worth fully exploring, and I wish we had time for a question period to explore these deep questions farther. But our time has run out. I suggest that, if any of you in the audience have questions or comments, you send them by mail to our office; we will see that they reach Lord Cromer or Dr. Holtrop.

Before we adjourn let me say a word about the future: We are planning tentatively to have our next meeting in 1969, just before the meeting of the World Bank and Fund in late September. We are thinking in terms of a session on the problems of adjustment; I think one can guarantee that there will still be such problems at that time. In the meantime we will circulate to you the very interesting papers presented today, and we hope to keep in touch with you through the years.

Now all that remains for me to do is to express again our great appreciation to Governor Åsbrink and to our two speakers today, who have given us a most interesting afternoon. The meeting is adjourned.

WRITTEN COMMENTS

Time did not permit during the Stockholm lecture meeting the usual oral discussion of the papers presented. Accordingly, copies of the papers were subsequently sent to a few interested persons, most of whom were, in fact, present at the meeting, and their comments invited. Comments were received from Robert V. Roosa, Otmar Emminger and E. Stopper; the text of these comments are reproduced below.

Comment by Dr. Emminger

I am very much intrigued by Lord Cromer's proposal for the setting up of a European Monetary Board. This proposal raises a number of questions. I leave aside those which--while certainly very important--concern more the procedural side of the suggestion, viz.: Who will select and appoint the members of this Board? From which countries should they be selected? (Surely not all European countries could send somebody into a "small Board of men of standing," to use Lord Cromer's definition.) Should the members be full-time or part-time members, and would it be possible to win first-class people of high standing for a full-time job, if such should be the intention of Lord Cromer.

Besides these "procedural" questions, I want to raise two major questions of substance: First, will such a European Monetary Board (EMB) be able better (and more quickly) to discern monetary and fiscal developments endangering the stability of a member's money (again to use Lord Cromer's phrasing) than the existing international bodies? Second, are any confidential recommendations of the EMB to the member government concerned (or to all the members of the group) likely to have a decisively greater impact on the policies of the country concerned than the pressures of existing bodies?

I have some doubts on both counts. As to the first question, I doubt whether a small Board of men of even the highest intellectual standing could follow the fiscal and monetary evolution in a large number of countries in such detail and with such superior interpretation as to make it possible for it to give authoritative advice, except with the help of a fairly large permanent Secretariat with "country desks" for all the major countries. This would immediately lead us back to the organizational principles of, say, the OECD or the IMF. Moreover, even a highly organized and completely independent international Secretariat would still be very much dependent on the material (plus the interpretation attached to it) furnished by the country concerned. I remember the way in which the British situation was being evaluated in the crucial year 1964 whose record payments deficit of more than 2 billion dollars laid the ground for the ensuing exasperating weakness of the pound. The grave doubts which were voiced by foreign experts in some committees of the OECD since the spring of 1964 (and later again in 1965 and 1966) were largely blunted and controverted by over-optimistic interpretations and evaluations given in good faith by British experts, including those from the Bank of England. Would that be any different with the EMB?

Even more important is the question: What weight will the advice of an outside committee carry with governmental policy in the country concerned? Will not the Government claim--and rightly so--to be the ultimate judge on what it considers to be politically bearable, or, to put it more correctly, what it considers to be the proper political choice among various options (e.g., contractive policy versus devaluation, or tax increase versus cut in expenditure)? And finally: what influence is the confidential recommendation of an EMB likely to have on the behavior of trade unions and the--often crucial--evolution of wage costs? Such questions inevitably lead to some doubts about the efficacy of the raising of the exhortatory finger by yet another international body. To me, it seems more likely that the views of an outside body will be listened to if that body has also some hold on the purse strings, i.e., on financial assistance should any such eventually be needed. This gives some authority to the views of the IMF (and particularly its independent Staff) and also of Working Party 3 of the OECD (inasmuch as they act as the expert group for the Group of Ten).

A European Monetary Board even of the highest calibre, but without the base of an experienced international Secretariat and without the command over assistance funds, seems to me to be in a very unenviable position.

Comment by Mr. Roosa

These two papers epitomize one of Per Jacobsson's favorite precepts: the elements of central banking never change, but their application must be continuously adapted to a changing world. Both Dr. Holtrop and Lord Cromer focus on the central banks' unenviable position of conspicuous responsibility for reconciling forces that would otherwise have to be reconciled by brute strength if no central banks existed. However, because central banks simply must exist in modern economic society, they stand astride many of the selections that have to be made in the economic processes of sorting out competing alternatives, particularly as between the external requirements that a country must fulfill and its domestic aspirations.

Dr. Holtrop and Lord Cromer concentrate on this part of the central bank's role--that of finding an accommodation between those forces in the world economy which place limits upon the economy of each individual country, from the outside, and the internal forces which propel each national economy from the inside. Both Dr. Holtrop and Lord Cromer embrace the tested and traditional principles of central bank policy. They do not differ on what the aims of the central bank should be. They do differ in the way they would handle the relationships among the central banks of individual countries, in order best to achieve a harmonization among the policies which each actually pursues.

Dr. Holtrop sees no alternative to reliance on individual central banks, acting separately, to determine the particular mix of policies that will, in any given situation, best reflect the application of those common doctrines of central banking which all by and large would accept. Lord Cromer fears that individual central banks can have neither the independence nor the autonomy needed to fulfill the desired objectives. He turns instead toward reliance upon a supra-national body which would articulate the implications of common doctrine for the conditions of each individual country, and would hopefully have the power to see these implications carried through into action within each country.

Dr. Emminger has asked the important questions which Lord Cromer's approach would raise. Perhaps I might comment briefly on Dr. Holtrop's penetrating analysis.

Dr. Holtrop's position is, quite simply, that as long as nations have a separate identity, their central banks will each inevitably formulate a separate policy. It will always be in the interests of each, however, to attempt to coordinate with all. The need for such coordination will become even more impelling among the members of a common market group. But even among them, the most to be expected is uniformity in the choice they all make among alternative policy guidelines.

Dr. Holtrop suggests three alternative approaches: (a) fully offsetting the effects on internal liquidity created by changes in a given country's external liquidity; or (2) allowing external effects upon home liquidity to work whatever effect they will, after the central bank has taken domestic action to assure that sufficient liquidity will be available, in any event, to provide for the normal requirements of the home economy at stable prices; or (3) deliberate variations in internal liquidity to expand or contract the home economy as much as may be needed to maintain an appropriate amount of external liquidity.

Dr. Holtrop interestingly catalogues various episodes in the postwar monetary history of the Netherlands Bank, and of several other countries (including the United States), among these three alternative approaches. While some might quarrel with one or another of his characterizations, none surely can question that he has isolated three patterns which have, at various times, each been relevant in one or more situations. I would only question whether his catalogue of three approaches is sufficiently large. For example, I doubt whether any of the three, taken as he states them, would adequately encompass the implications of the enlarging scale of capital flows among nations, particularly among the leading countries, and most notably in recent years through the Euro-currency market. I also doubt whether any of Dr. Holtrop's three approaches could at any time be sufficient for a nation whose own currency is in wide use by other countries as an international medium of exchange and store of value.

Whether or not Dr. Holtrop's catalogue exhausts the possibilities that will be relevant over the years ahead, his analysis has brilliantly illuminated the experience which he so uniquely shared during his remarkable tenure as Governor of the Netherlands Bank and President of the Bank for International Settlements. As so many of us, Dr. Holtrop rightly attributes much of what he thought and did to the stimulus of Per Jacobsson. It is for the rest of us to affirm, as well, the great debt that all central banking theory and practice for many future generations will owe to Dr. Holtrop himself.

Comment by Dr. Stopper

In his interesting remarks, Lord Cromer draws on the rich experience which he gathered as Governor of the Bank of England during a troubled phase in the British economic and monetary history.

He has witnessed more closely than many another central bank governor how thoroughly official diagnoses may be upset by any thinking committed to politics and what powerful obstacles in the home field may stand in the way of taking such action as appears necessary according to the criterion of actual economic facts. It is therefore understandable that he calls for an independent international Monetary Board which would have to ascertain with great expert knowledge the causes and the extent of an undesirable monetary and economic development and to recommend the necessary corrective measures. The standing of this Board would have to be so high as to make it practically impossible for governments and parliaments to ignore its recommendations. It may well be added that such an authority would also be very useful in the battle against the present world-wide trend towards inflation. It might direct any major country to counter in good time any excess in demand and thus also avoid any export of inflation to other countries.

The objective aimed at by Lord Cromer can in my opinion only meet with our approval; however, whether it is possible to achieve it under present conditions by the proposed means, is a different question. In going into this, one will have to take as a basis the experience made so far by a number of international bodies devoting themselves to similar tasks.

Some of these bodies are composed of most competent personalities enjoying a high reputation internationally. For purposes of increased efficiency some of them are deliberately kept small, but in individual cases they have at their disposal a sizeable staff of qualified collaborators who are free of national commitments.

Some of these groups of experts are quite specifically concerned with the early detection of undesirable developments and with the appraisal of the necessary corrective measures. They do not hesitate to submit quite insistently clear-cut recommendations, both orally and in writing, to the respective governments.

The essential point in which these groups of experts differ from the authority proposed by Lord Cromer, however, is that their members are government representatives.

I hardly think that as far as the handling of problems is concerned there is any material difference between the behavior of highly qualified government representatives and that of independent experts of outstanding calibre, for the thinking and acting of both categories of experts must be above all directed to keeping the monetary system capable of functioning. In this endeavour, the attitude of all the personalities involved will presumably be influenced by their own point of view in economic matters and by their personal experience. In this respect, it is hardly to be assumed that differences of any material significance between the two categories of experts would have to be expected.

The results achieved by the existing bodies are quite remarkable. Yet in some specific cases, which are admittedly very important ones, they have been unsatisfactory. However, this is hardly due to the fact that the board members concerned were government representatives. Owing to the complexity of prevailing conditions it was not possible in these particular instances to detect at once any wrong assessments made by national authorities. Consequently, it was not possible either to influence in good time the course of events by recommendations or by exerting pressure of some kind.

It is doubtful whether a Monetary Board composed of independent representatives would have achieved better results.

Once the causes of an undesirable development and the required corrective measures are really recognized, the influence of government representatives, who in most cases have also a say in the granting of monetary assistance, should be rather greater than that of independent experts.

The question arises, however, whether recommendations made by an independent Monetary Board would help the governments to overcome more effectively opposition within the country against a policy recognized as being the right one. Based on personal experience made in my own country, I rather doubt whether under present conditions this question may be answered in the affirmative without further qualification. But even those who are inclined to give a positive answer will have to consider that such an independent body, merely as a result of a few false appraisals which it seems hardly possible to avoid, might lose its reputation and its influence on the general public more quickly than a group of government representatives, for its standing and power would entirely be based on the soundness of its judgment. This is much less so in the case of the latter, as each country is dependent on the goodwill and the support of its partners whose advice cannot be disregarded.

Lord Cromer would like to see membership of the Monetary Board restricted to European countries, not least because of the fact, presumably, that this would offer the possibility of promoting European economic integration in the monetary field. It is doubtful whether this objective can be reached, for so long as no further progress of any importance is achieved in the remaining spheres of integration it might prove difficult to advance in a decisive way in the very sector which is the most complex one of all.

If, as suggested, the United States of all nations were not to participate in the proposed Monetary Board, this would be deplorable, for the main problem of international monetary relations at the present time is precisely the imbalance in payment transactions existing between the United States and some of the industrial countries of Europe. It is for this very reason that whenever efforts are made to bring about an improvement in the stabilization of the currencies--which is the purpose to be served by creating the Monetary Board--the United States in particular should also take part.

It would be desirable, no doubt, if it were possible for the tasks outlined by Lord Cromer to be discharged in a perfect way by an international monetary authority.

Under present conditions, however, it must be doubted whether the proposed Monetary Board would be capable of accomplishing these tasks more satisfactorily than the existing bodies.

Moreover, the exclusion of the United States as the major monetary factor would constitute a deficiency. It is hardly to be assumed that this shortcoming would be offset by the effects of the activity by an independent European Monetary Board stimulating integration.

Despite the objections raised, Lord Cromer's proposal ought not to be dismissed once and for all. On the contrary, it should be re-appraised from time to time as to its usefulness in the light of changing conditions.

APPENDICES

BIOGRAPHIES

Dr. M. W. Holtrop

Marius W. Holtrop was born in 1902 in Amsterdam, Netherlands. He was educated at the University of Amsterdam and received his doctor's degree in economics with a thesis on the velocity of circulation of money (1928).

Dr. Holtrop's career, a happy mixture of industrial activity and central banking, began with his employment at the Royal Dutch Blastfurnaces and Steel Works (1929-36). Initially an assistant in their economic research department, he soon became a manager in the Ammonia Division, a joint venture of Steel Works and Shell. Already during this period, the period of the great depression, Dr. Holtrop took an active part in monetary controversy by supporting arguments in favour of devaluation of the guilder.

In April 1936 Dr. Holtrop became Vice President of Shell Chemical Company in San Francisco, only to return to the Royal Dutch Blastfurnaces and Steel Works three years later--this time as Managing Director (1939-46). During the last years of German occupation he participated in the work of a mixed group of businessmen and economists which studied the problems of postwar finance. The group's report was presented, after liberation, to the incoming government and became the foundation for the monetary reform and the special taxation measures which contributed so much to the country's recovery. It was this work that brought Dr. Holtrop into contact with the then Minister of Finance, Prof. Dr. Pieter Lieftinck, and it was on the latter's recommendation that, by Royal Decree, Dr. Holtrop was appointed President of the Nederlandsche Bank. He served in this capacity for three terms of seven years, from May 1, 1946 until his retirement last year.

Dr. Holtrop has also been active in international affairs. In 1946 he was elected a member of the Board of the Bank for International Settlements in Basle and later became its President and Chairman of the Board (1958-67). He represented his country on the Board of the International Monetary Fund as Alternate Governor (1947-52) and as Governor (1952-67). His authority as a monetary expert found recognition in his appearances before the Radcliffe Committee (1958) and before the Royal Commission on Banking and Finance of Canada (1962). When the Committee of Presidents of Central Banks of the European Economic Community was created, he became its first chairman (1964).

In his own country Dr. Holtrop has been a member of the Social Economic Council since its inception (1950). Among his nonprofessional activities, his chairmanship of the alumni association of the University of Amsterdam should be mentioned. Dr. Holtrop is a member of the Royal Netherlands Academy of Sciences. He received honorary doctor's degrees from the Netherlands School of Economics in Rotterdam (1963) and from the University of Basle (1967). He has also been the recipient of many governmental honours which culminated in the Grand Cross, Order of Orange Nassau (Netherlands) and the Grand Cross, Order of the Crown (Belgium).

The Earl of Cromer

George Rowland Stanley Baring, P.C., M.B.E., the 3rd Earl of Cromer, has been a banker for most of his life, in London, Washington and New York. He is currently, and was from 1949 to 1959, Managing Director of Baring Brothers & Co., Limited, a firm founded by his family in 1760. From 1961 to 1966 he was Governor of the Bank of England and a Director of the Bank for International Settlements in Basle. For two years before that, Lord Cromer served in Washington as Economic Minister at the British Embassy, head of the United Kingdom Treasury and Supply Delegation and United Kingdom Executive Director in the International Monetary Fund, the International Bank for Reconstruction and Development, and the International Finance Corporation.

Lord Cromer, who was born in 1918, was educated at Eton College and Trinity College, Cambridge. During World War II he served with the Grenadier Guards in Europe and was demobilized as Lieutenant Colonel. In 1966 he was appointed a member of Her Majesty's Privy Council, the third successive generation of his family to receive this honor. He holds an honorary LL.D. from New York University.

THE PER JACOBSSON FOUNDATION

SPONSORS

Honorary Chairmen

EUGENE R. BLACK--United States--former President, International Bank for Reconstruction and Development

MARCUS WALLENBERG--Sweden--Vice-Chairman of the Board, Stockholms Enskilda Bank

Chairman

W. RANDOLPH BURGESS
United States--Director, Atlantic Council
former United States Ambassador to NATO

HERMANN J. ABS--Germany--Chairman, Deutsche Bank A.G.

ROBER AUBOIN--France--former General Manager, Bank for International Settlements

WILFRID BAUMGARTNER--France--President, Rhone-Poulenc; former Minister of Finance; former Governor, Banque de France

S. CLARK BEISE--United States--Chairman of the Executive Committee, Bank of American National Trust and Savings Assn.

B. M. BIRLA--India--President, Birla Brothers Private Limited

RUDOLF BRINCKMANN--Germany--Partner, Brinckmann, Wirtz & Co.

LORD COBBOLD, P.C.--United Kingdom--Lord Chamberlain; former Governor, Bank of England

MIGUEL CUADERNO--Philippines--former Governor, Central Bank of the Philippines

R. v. FIEANDT--Finland--former Prime Minister; former Governor, Bank of Finland

MAURICE FRERE--Belgium--President, Sofina; former Governor, Banque Nationale de Belgique; former President, Bank for International Settlements

E. C. FUSSELL--New Zealand--former Governor, Reserve Bank of New Zealand

ALY GRITLY--United Arab Republic--former Chairman, Bank of Alexandria

EUGENIO GUDIN--Brazil--President, Instituto Brasileiro de Economia, Fundaçao Getulio Vargas; former Minister of Finance

GOTTFRIED HABERLER--United States--Professor, Harvard University

VISCOUNT HARCOURT, K.C.M.G., O.B.E. United Kingdom--Managing Director, Morgan Grenfell & Co., Ltd.

GABRIEL HAUGE--United States--President, Manufacturers Hanover Trust Co.

CARL OTTO HENRIOUES *

M. W. HOLTROP--Netherlands--former President, Bank for International Settlements

SHIGEO HORIE--Japan--Chairman, Committee on International Finance, Federation of Economic Organizations; former Chairman, Bank of Tokyo, Ltd.

CLARENCE E. HUNTER--United States--former United States Treasury Representative in Europe

H. V. R. IENGAR--India--Chairman, The E.I.D.-Parry Group; former Governor, Reserve Bank of India

KAORU INOUYE--Japan--Chairman, Dai Ichi Bank, Ltd.

ALBERT E. JANSSEN *

RAFFAELE MATTIOLI--Italy--President, Banca Commerciale Italiana

J. J. McELLIGOTT--Ireland--former Governor, Central Bank of Ireland

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 *

FEDERICO PINEDO--Argentina--former Minister of Finance

ABDUL QADIR--Pakistan--former Governor, State Bank of Pakistan

SVEN RAAB--Sweden--Managing Director, Göteborgs Bank

DAVID ROCKEFELLER--United States--President, Chase Manhattan Bank

LORD SALTER, P.C., G.B.E., K.C.B.--United Kingdom--former Director, Economic and Financial Section of the League of Nations; former British Government Minister

PIERRE-PAUL SCHWEITZER--France--Managing Director, International Monetary Fund

SAMUEL SCHWEIZER--Switzerland--Chairman, Swiss Bank Corporation

ALLAN SPROUL--United States--former President, Federal Reserve Bank of New York

WILHELM TEUFENSTEIN--Austria--Director, Oesterreichischen Investitionskredit A.G.

GRAHAM TOWERS--Canada--former Governor, Bank of Canada

JOSEPH H. WILLITS--United States--Professor, University of Pennsylvania

* Deceased

Board of Directors

W. RANDOLPH BURGESS, Chairman, Washington

EUGENE R. BLACK, New York City

MARCUS WALLENBERG, Stockholm

GABRIEL FERRAS, Basle

PIERRE-PAUL SCHWEITZER, Washington

Officers of the Foundation

W. RANDOLPH BURGESS, President

ALBERT S. GERSTEIN, Vice-President and Legal Counsel

GORDON WILLIAMS, Secretary

CHARLES E. JONES, Treasurer

PUBLICATIONS

Proceedings

1964 *Economic Growth and Monetary Stability*

Lectures by Maurice Frère and Rodrigo Goméz
(Available only in Spanish; English and French stocks exhausted)

1965 *The Balance Between Monetary Policy and Other Instruments of Economic Policy in a Modern Society*

Lectures by C. D. Deshmukh and Robert V. Roosa
(Available only in French and Spanish; English stocks exhausted)

1966 *The Role of the Central Banker Today*

Lecture by Louis Rasminsky
Commentaries by Donato Menichella, Stefano Siglienti, Marcus Wallenberg and Franz Aschinger
(Available only in English and Spanish; French stocks exhausted)

1967 *Economic Development--The Banking Aspects*

Lecture by David Rockefeller
Commentaries by Felipe Herrera and Shigeo Horie

Other Publications

The Role of the Central Banker
as set forth by Per Jacobsson in his speeches and articles from 1921 to 1961
(Available in English only and in limited quantities)

The Per Jacobsson Literary Inheritance
reprint of article by Erin E. Jucker-Fleetwood which appeared in Vol. XIX--1966--Fasc. 4 KYKLOS--The International Review for Social Sciences--Basle
(Available from the Foundation in English only and in limited quantities)