KEYNES LECTURE IN ECONOMICS

THE INTERNATIONAL MONETARY PROBLEM

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I

MAY I begin by expressing my deep sense of the honour of being asked to deliver this, the second of the Keynes Lectures founded by the Academy? I will not attempt to traverse the ground so felicitously covered by Professor Robinson in the inaugurating lecture which was devoted to an exposition and appraisal of Keynes's approach to our subject. But I would like to pay my humble tribute to Keynes's place in our generation. Whether you agreed with him or not—and it would have been something of a miracle to have been in agreement throughout with his numerous vicissitudes—it would have been poverty of spirit to deny either his pre-eminence as a thinker or the life-enhancing qualities of his personality. He shook us up and stimulated us to new thought by his intellectual speculations. He cheered us and inspired us by his friendship and his idealism.

I have chosen for my topic the International Monetary Problem. This is a subject to the discussion of which Keynes made many contributions throughout his career, and on which his attention was especially focused during those last years when he sacrificed health and leisure and eventually life itself in a supreme effort to solve the practical problems confronting this country and the world in this connection. I do not know what he would have thought about what I shall say this evening. The world has changed a great deal since he left us. But I am sure he would have welcomed candour and the expression of individual opinion. He could create fashion and he often did. But he never hesitated not to follow it if he felt otherwise. And in this connection I am afraid I cannot concoct an uncontroversial discourse.

II

The nature of the problem I have chosen reveals itself at once in the title. In the world as at present organized—and as it is

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likely to be organized for a long time in the future—there is more than one money, more than one ultimate control of the volume of spending power available; and in practice important problems arise in the relationships between the various moneys —problems which arise from disequilibria in the markets for foreign exchange or, to use a phrase which, in popular discussion at least, causes more confusion than clarification, deficits or surpluses in balances of payments.

It is important to realize that these difficulties are not logically inevitable. It is quite possible to think out models in which they do not occur.

If, for instance, the means of payment in the different national areas consisted only of coins of the same metal freely melted, minted, and traded, and if the sole activities of the national authorities related to the denomination of the coins in their respective areas, then the only difficulties which could arise in the exchange markets would be delays of a purely technical nature. To all intents and purposes it would be as though there were one international money. The automation of the specie-flow mechanism of the books would be a reality.

In the same way, with less primitive national monetary systems, with substitutes for metal, notes, and bank credit forming the main element in the circulation, it is still possible to conceive, although, as we shall see, in practice less probable, an absence of disharmony. If the movements of the credit bases in the different areas are so controlled as to make the local flows of expenditure correspond to what they would have been had there been one international money, then again there could be no long-lasting disequilibria in the exchange markets, no trouble with balances of payments.

This was indeed the theory underlying the gold standard, or of standards founded on metals in general in so far as they conformed to these model relationships. Whether in fact the gold standard so worked in practice and how the greater part of the world managed to keep in some sort of orderly relationship at fixed exchange rates, are questions which might well occupy many lectures and dissertations. But although a metallic standard of this kind has not been in operation lately, and although there are many reasons for supposing that it would not be viable in contemporary conditions, it would be unwise to dismiss as worthless the subtle intellectual analysis which lay behind the theory. I do not refer to the Bank Chairmen's speeches of my young days—Keynes's 'parrots', as he called them. I refer

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rather to David Hume's masterly analysis of the self-righting character of purely metallic—as distinct from credit—systems, and to the Ricardian 'law' of the distribution of the precious metals. Even if we think that these belong to a world never likely to exist, or which ought not to exist, they still have valuable analytic lessons, if only by way of contrast.

In practice, however, as we know, conditions have often existed inimical to the harmony which might be expected from the contemplation of these models. It would be easy enough to put these into a few lines of pure abstract algebra. But for my purposes it will be convenient to advance on a more pedestrian level.

We may take as the first important example of malfunctioning of international monetary relationships the fixing of inappropriate parities, when the original relationships have been interrupted by war, or some similar catastrophe outside the ordinary working of the system. As is notorious, this has happened twice in British monetary history: once after the Napoleonic Wars when the deflation which developed partly as a consequence of an anticipated return to cash payments at the old parity was responsible for mass unemployment, agricultural distress, and grave social disturbances, of which the so-called Peterloo massacre is an outstanding example; and again after the First World War when, having learnt nothing from history, the influence of the dominant school of expert advisers committed an almost exactly similar blunder, to the lasting detriment of our economic power and standing in the world. It was in combating the results of this fateful decision that Keynes wrote some of his most vivid polemical essays.

But the disharmony caused by deliberate decisions of this sort is only a leading species of a much wider genus. The disharmony between flows of expenditure, to which it automatically gives rise, may equally be engendered, if the operation of the independent money supplies in the different national areas does not conform, roughly speaking, to the conditions which I have already elaborated for the successful functioning of credit systems founded on metal, namely that there should be adjustments so managed as if there were a truly international money. The different centres of money supply may manufacture purchasing power in quantities mutually incompatible with equilibrium on the exchange markets at fixed rates.

Now this may very easily happen. Indeed there is a strong probability that in modern conditions it is likely to happen. While safeguarding the reserve was the major preoccupation of central

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bank policy as it was supposed to be—and often was—under the gold standard, there was a certain presumption that, if the effects of such a failure to keep in step became an embarrassment, corrective measures might be taken. This did not always happen or happen in time. But it would be a great mistake to suppose that it never happened or that it did not happen fairly frequently.

Once, however, that safeguarding the reserve has ceased to be the main principle of operation, the likelihood of the maintenance of the required relationships between the various money supplies is greatly diminished. Once central banks are required to take care of the local pace of economic activity, to provide finance for whatever local fiscal measures are deemed to be desirable, to regulate the pace of investment and so on, and so forth, then the probability of disequilibria in international monetary relations is much greater. It need not happen. It is conceivable that co-operation between central banks as regards the general objectives of policy may do something to diminish the danger of any one bank getting radically out of step. But it is certainly not to be expected that this kind of informal co-operation will bring about the desired result if considerations of internal policy in the national areas concerned are working in the opposite direction. Realization that the so-called automatism of the price system relates to *relative* rather than *absolute* prices, and this of course subject to well-known exceptions, has brought about a climate of opinion in which intervention to prevent deflation or to maintain employment is almost inevitable, at least in democratic communities: and since there is a multiplicity of states each claiming complete sovereignty in regard to demand management, it is virtually inevitable that from time to time there should arise disequilibria between the different national moneys.

III

But does this matter? Is there a problem of practical action in the sense in which that hackneyed phrase is used every day in the newspapers? Is this not only a problem because of an artificial fixity in the exchange markets based upon wrong-headed perverse analysis, and false conceptions of national prestige? Why should not the rates at which the various national moneys exchange for one another—and therefore the balancing of payments—be left to the forces of free markets? Why should those

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who believe in freedom elsewhere refuse to admit the case for freedom in this connection? Clean floating all round—to use the fashionable jargon—that is the obvious solution.

That is a point of view which is commonly to be heard when matters of this sort are discussed nowadays; and it is a point of view which is held openly or secretly by many of the best minds in our subject. Certainly a majority of those professional economists at home and abroad, with whom I should most like to agree, are proponents of this attitude. Yet with the best will in the world, and with a natural desire at my time of life not to fall behind the march of mind, I find it difficult to persuade myself that it is not over-simple. I do not believe that the desired situation would arise from unlimited freedom. I do not believe that the analogy between the effects of individual price changes and fluctuations in exchange markets is convincing without an elaboration which takes us a considerable distance from the desirability of clean floating all round. In short I do not find this intellectual position much more helpful than many of the conventional arguments which it opposes.

But before I set forth the grounds for scepticism in this respect let me make quite clear the nature of my target. It is the conception of floating rates as a *general* solution which is in question. I have no objection in principle to floating any one rate for an experimental period—or even in perpetuity if the currency in question is not particularly important. Whether such a policy is expedient or not from the point of view of the national interest involved is surely a very empirical question to be decided in the light of the facts of each particular situation. Certainly if I had been an adviser to Her Majesty's Government the other day, when justifiable apprehensions of continuing inflation were leading to a massive depletion of our reserves, I should have advised the policy actually adopted of letting the pound sterling float. But, I repeat, this is not what I am here to discuss. The subject of this lecture is the *International* Monetary Problem; and the question I am concerned with is not the desirability of an individual float but rather the desirability of floating all round.

Now this is not an altogether imaginary state of affairs. As I shall be arguing in a moment, completely free floating all round —*clean* floating—is not something which has ever happened or is ever likely to happen; but controlled floating—dirty floating, as it is called—has certainly occurred on a large scale twice in history: once for some time in the thirties after the collapse of

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the gold standard, first in the United Kingdom, and then later in the United States; and once just recently when President Nixon announced the inconvertibility of the dollar.

What happened? In both cases there was a tendency for so-called weaker currencies to hitch themselves to the stronger, either to the pound or the dollar. On the first occasion we witnessed the formation of the famous sterling area which broke up only the other day. So far as the stronger currencies were concerned, on the first occasion there ensued a period of almost indescribable confusion, competitive depreciation on the part of the U.S., frantic deflation on the part of the so-called gold bloc, and a state of febrile chaos in the exchange markets, especially the markets for forward exchange, which must have increased quite considerably the mortality from high blood pressure and thrombosis. Eventually the main powers concerned came together and re-established some sort of order with the celebrated Tripartite Agreement which involved pledges to consult before changes outside comparatively narrow margins were in contemplation.

On the second occasion, the recent declaration of dollar inconvertibility, we saw an almost immediate response of the chief central banks to prevent the situation getting out of hand as in the thirties. We saw the imposition of controls, intervention on the exchange markets, and eventually the *ad hoc* Smithsonian Agreement, under which most of the large centres, save the United Kingdom, are at present supposed to be operating, pending the emergence of a more perfect system promised shortly (with some variations) by most leading finance ministers.

The practical moral of all this, I suspect, is that, whatever happens, we are not likely in the present organization of the world to see clean floating all round: the confusion in the exchange markets and the resulting speculative capital movements, for good or for bad reasons, make it highly distasteful to those who are in control. But there is a deeper reason why it is improbable: it arouses tendencies which, although not so obtrusive as the divisive tendencies of independent financial policies, are quite as deeply rooted in the motivations which animate financial and commercial life—namely, the tendencies continually to seek stability in capital values—or better said, to avoid depreciation thereof. In my judgement nothing can be more certain than that with genuine clean floating, i.e. no controls and no prohibition concerning financial contracts, there would be operative strong forces tending to eliminate the use of the currencies expected to be weaker in real terms and to make more and more

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bargains in terms of those expected to be stronger. It is not true to say that the whole creation yearns for stable money: for there are certain sections which do quite well out of instability. But it is certainly true to say that there is a widespread yearning for such security and that, in the absence of penalties prohibiting the search for safety, it will manifest itself in practice.

I have couched all this in rather abstract terms. But I assure you it is no flight of abstract imagination. The tendency it describes has shown itself again and again in history. When gold and silver were both in use as national currencies in different parts of the world, there became manifest a strong tendency for gold to displace silver because it was thought more likely to hold its value. In the great hyper-inflations after the First World War, in the days before we had learnt all the subtleties and horrors of exchange control and such policies, there existed in all the areas concerned a disposition so strong to make all bargains in sterling or gold, that eventually it contributed greatly to the more rapid deterioration of the local currencies. If it had not been for the almost general prohibition of the gold clause in commercial contracts, how much narrower would have been the scope for local inflations in our own day. The condition *sine qua non* for the persistence of clean floating all round, therefore, is the suspension of freedom, to avoid the use of one's local currency if it is thought liable to depreciate—coupled with the most ferocious penalties for evasion—which is surely a mordant reflection on the contention that free floating all round is the ultimate *liberal* solution of the international monetary problem.

My conclusion, therefore, is that either free floating all round would be defeated by the conditions which made true freedom possible or that, a much more probable event, it would never be allowed to happen for very long because of the consequences it would entail. If there is to be a regime of rates floating all round beyond certain comparatively narrow limits, it will almost certainly be dirty, i.e. controlled, floating with all the possibilities that that entails—competitive devaluations, extensive limitations on trade and investment, and so on. If that is not to happen, it follows that there must be some sort of supra-national system—a framework of agreement and international law within which national policy must move. To the examination of the possibilities in that respect, I must now ask you to direct your attention.

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IV

I should like to begin this part of my lecture by some observations on the so-called Bretton Woods System. Both in origin and in obligations this is often misunderstood; and it is a system to which the great man after whom this lectureship is named devoted much thought and precious vital energy.

To understand this system it is necessary to consider its historical background. The historian of the future will get things all wrong if he judges the theory of the International Monetary Fund solely in terms of the difficulties which have emerged in the course of its operation. These difficulties are important; but, as I hope to show, they are not all intrinsic to the fundamental conceptions. And these fundamental conceptions are to be understood only in the light of the events of the years which preceded the creation of the new system.

This relevant background is essentially twofold: first, deflation and chaos and competitive devaluation in the exchanges. The Great Depression was characterized by a degree of general deflationary pressure unprecedented for over a century; and most of the best minds of the age, including conspicuously Keynes, regarded it as the chief menace of the future. Once the war was over and a brief restocking boom, the incentive to invest would be poor and the world would be confronted with the prospect of secular stagnation. Secondly, the breakdown of the gold standard initiated by the suspension of convertibility of the pound sterling in 1931 had inaugurated a period of appalling uncertainty in international finance, terminated only by an agreement by the United States, France, and the United Kingdom, shortly before the war. It was these troubles that dominated the minds of the advisers of both the U.S. and the U.K. Treasuries in their plans for international reconstruction. And the central conception of the plan which eventually emerged from their deliberations was correspondingly essentially twofold: first, a central fund to enable central banks in difficulties to put their affairs in order without deflations precipitating another worldwide depression, and secondly, arrangements whereby adjustments of exchange rates to meet fundamental disequilibria—to use the terms of art then employed—could be negotiated by common agreement rather than by independent action.

How has this system worked? I have sometimes heard, or read of, talk as if, since its inception, the world had been crucified on a Bretton Woods cross to the incredible detriment of welfare

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generally. This seems to me just silly. I certainly would not wish to attribute to the existence of the system the unprecedented rates of growth which have taken place in most parts in the last quarter of a century—even in the United Kingdom, whose performance in many respects compares so ill with that of most Western powers, the rate has been quite respectable compared with most other periods of modern history. But at least it can be said that the general picture is not one of strangulation: and I would argue that some at least of the comparative degree of order which has prevailed and some, too, though not all, of the much greater disposition on the part of the powers that matter in this respect to co-operate and extend mutual aid has been due to the existence of these institutions and their dedicated officials.

Nevertheless it would be absurd to pretend that in every respect the Bretton Woods System has realized the ambitions of its founders or that some features have not proved to be open to criticism. Let me try to outline its main deficiencies as they have emerged in the course of recent history. I shall mention four.

I begin with a point which some of you may find violently provocative. In my judgement the constitution itself is defective. The Bretton Woods statutes were elaborated at a time when most people were still under the spell of the one-world philosophy: and although in respect of voting rights they are not as absurd as those of the United Nations Assembly which give equally one vote to San Salvador and to the Soviet Union, the constitution is still such as to involve too large an executive, and also too large a governing body. I would say that it is an axiom of administration that you cannot discuss such matters as the adjustment of exchange rates in a meeting of more than a very few persons, especially with all the amenities of modern telephonic communication available in the corridors. Certainly, in practice, all the major decisions in this respect have been arranged on the side, with the executive body of the Fund used mainly as a rubber stamp. With hindsight I am sure that, rather than drag in all and sundry who wished to come in, it would have been better to have made the old tripartite agreement the basis of the constitution, with suitable enlargements to bring in representatives of other major centres. It follows that, at the present time, I should regard it as highly retrograde if it were attempted to substitute for the informal Group of Ten, which has gradually arisen to meet this deficiency in the constitution, the so-called

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Group of Twenty, which exists to discuss the purely *ad hoc* question of constitutional change. The justification of such a policy would be purely sentimental; and it would be less likely to achieve satisfactory results in practice.

I now come to mechanics. Popular mythology invests the Bretton Woods system with imposition on the constituent members of perpetually fixed exchange rates. This is pure misconception. It was one of the purposes of the plan to provide for orderly changes of exchange rates when there existed a fundamental disequilibrium; and it is clear to me that, ambiguous though that phrase may be, it could have been used to justify more changes than have actually taken place. It is probably true that the use of the adjective 'fundamental' implied a bias against light-hearted change—a position which is capable of reasonable defence. But the reluctance to change which has been a characteristic of the policy of certain governments, has been something imported into the system for extraneous reasons. These may have been defensible or otherwise—I do not think it was necessarily discreditable for the late Labour government to pay some heed to their obligations to foreign holders of sterling balances, however much our policy since the war in that respect has been open to criticism. But be that as it may, I think that experience has shown that more flexibility as regards unilateral adjustments was desirable. This was something which U.K. representatives fought for in the preliminaries to Bretton Woods. It is unfair to Keynes's memory to blame him for lack of more elbow room in the statutes as finally drafted.

The next deficiency is in respect of inflation. The Bretton Woods System, devised as I have said against a background of deflation and fears of deflation, contains no direct instrument for checking a world inflation—save a possible marking down of the price of gold—an almost inconceivable development, having regard both to the rules with which any change in the price of gold is hedged about and to the very dubious effectiveness of such a policy. It is true that the nature of the ultimate fund itself, a mixed bag of currencies with highly complicated and limited drawing rights, can be said to impose some indirect limitation on inflations initiated independently by the constituent members; and that these limitations are greater than would have existed under the constitution of Keynes's proposed Clearing Union, or might exist in the event of the world going over completely to Special Drawing Rights as the ultimate instrument of international settlements. But the fact is that there is

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no obvious means of controlling world inflation: and that this has shown itself very vividly in practice.

Finally, in the last few years it has proved a great deficiency of these arrangements that in effect they have meant that the monetary systems of its members are in important respects on a dollar system. It is a signal comment on the deficiences of foresight that, so far as I know, at the time of drafting the possible inconveniences of this did not present themselves as a serious problem. It is true that the statutes were drafted in such a way as to put the dollar in the front of the picture. But what did that matter? Here was the U.S. with the greatest reserve of gold in human history. Here was nearly every prominent expert in the world (except Keynes) predicting a chronic scarcity of dollars in the future. We ought perhaps to have anticipated that Congress, fed up with Mr. Roosevelt's earlier antics, would impose iron limitations on the alteration of the price of gold in dollar terms. But who (even Keynes) would have predicted that one of the problems of the sixties would be the superabundance of dollars making, at fixed exchange rates, a world inflation in dollar terms very difficult to resist? Who would have predicted that for this reason, the central banks of some powers which, unlike Great Britain up to then, had known what brisk inflation implies, would become more and more reluctant to go on adding dollars to their reserves or, alternatively, to allow media based upon them to depreciate the value of their own currencies? Clearly this was an important defect and one which eventually, when the continuing deficit in the U.S. balance of payments was leading to what was regarded as an intolerable strain on the U.S. reserve, had, as its eventual consequence last year's declaration of inconvertibility of the dollar and the breakdown of the Bretton Woods System. Then, as I have already said, so great was the apprehension of complete chaos on the part of those responsible for the major currencies, that temporary arrangements for the restoration of some order were made at the conference at the Smithsonian Institute. But, from the outset these were recognized to be merely provisional; and the run on the pound this summer has demonstrated once more the fragility of the present position.

The question therefore arises, what ought we to do? I want to devote the remainder of this lecture to preliminary reflections on this important problem.

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V

I begin with exchange adjustment. I take it that unless we are content with the prospect of complete freedom all round, which I have already examined in some detail, we are agreed that there should be some system of common rules. We really should not aim at the total absence of system of the mid-thirties, with all its potentialities of competitive depreciation, trade wars, arbitrary limitations on capital investment, and the likelihood of political friction that this implies.

I therefore see no alternative to the existence of at least nominal parities reached by agreement between those responsible for what used to be called key currencies. I am not so interested in what happens with the smaller fry—fluctuations there can be damaging according to the volume of trade and investment involved; but experience shows that the majority tend to follow one or other of the larger centres; and as we have seen, there are constitutional reasons for not making them more prominent than they are already in the existing international machinery.

But while retaining a central network of negotiated parities I would wish the existing rules and practice to be modified in two ways.

First, I would hope for considerably wider margins within which rates should be allowed to fluctuate without seeking common agreement. I think this is desirable, both in order to give central banks elbow room in which to cope with sudden or perverse movement of capital, and also to provide indications in advance of the desirability of more fundamental agreed change.

Secondly, I would seek some recognition more overt than anything which appears in the statutes of the desirability of changes of rates when situations of imbalance are developing. By this I do not mean that the whole fabric of monetary agreements and the value of reserves and investments should be upset every time there is some slight flicker in balance of payment statistics, which notoriously are reliable only within wide limits. But I do mean that, once something like a persistent trend has manifested itself, then it is better to change quickly than to wait, Micawberish, for something to turn up and save the situation.

I would like, however, to put some slight gloss on this desideratum in regard to *upward* valuations. Most of the discussion in recent years has related to the desirability of prompt devaluation once the results of internal cost or demand inflation (or

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both) have made themselves manifest and, as I have said, I quite agree with them. Quite recently, however, there have been voices, particularly on the American side, urging that if the authorities of an area find themselves in a persistent balance of payments surplus, it is their moral duty to appreciate their rate of exchange so as to help the restoration of international equilibrium.

Now I quite agree that in such a situation appreciation is very often in the local national interest. If, in one area, the value of money, in the form of internal purchasing power, is kept more stable than elsewhere, then it is likely that it will enjoy a favourable balance of payments and an increase of its reserves; and in such circumstances an upward change in the rate may well be advisable and is certainly justifiable in terms of international good conduct. We have all agreed for a long time that there is no obligation to import other people's *deflation*—though this danger has considerably receded, to put it mildly. By a parity of reasoning, there is no obligation to import other people's *inflation*—which was a danger to which the Germans, the burnt children who rightly dreaded the fire, have been exposed in recent years. But I totally deny that if, in such circumstances, i.e. a lower rate of relative inflation, there happen to be local inconveniences in local appreciation, there is any obligation whatever to do so *just to help the countries with a higher rate of relative inflation out of their difficulties*. The policy of international monetary collaboration was not designed to make the world safe for permanent inflation in financially loose-living areas.

I turn next to the problem of convertibility. Clearly it is desirable that there should exist some generally accepted medium in which ultimate differences in international accounts can be settled. The question is what? Until recently it has been gold; although, until they became thought to be excessive, dollars, still ultimately convertible, provided the most generally used substitute. But now the dollar has been declared inconvertible; and we know that some of the best minds advising the U.S. Government are determined that it should remain so. The world is therefore confronted with a new problem and one which, in my opinion, it will be very difficult to solve.

It is interesting to ask what lies behind the intransigence of the United States in this respect. It is easy enough to understand the immediate grounds for the declaration of inconvertibility: while the dollar price of gold remained fixed by Congress and the U.S. balance of payments was in substantial deficit, with

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increasing disinclination on the part of other centres to accumulate dollars, it was not possible, while convertibility persisted, for the U.S. authorities to do what any other Government would have done in like circumstances, namely to devalue the dollar or allow it to float downwards. It may well have been thought that only the violent wrench of suspension of convertibility of what had become in effect the main currency of the Western World would create elbow room for adoption of this obvious expedient.

But short-run expediency is one thing, long-run dogma is another; and one is certainly led to wonder concerning the ultimate rationale of the *non possumus* attitude of influential U.S. advisers. It cannot be that they have only just heard of the view that there is an aspect of absurdity in devoting labour in extracting ores from one part of the planet which, when refined, are redeposited below ground in another. For that has been a commonplace of the more superficial discussion of these matters during the greater part of my lifetime; and certainly by itself it is not very conclusive. The human race does all sorts of things which, if in themselves slightly ridiculous, may yet have ultimate justification, if they help to maintain some order when no better alternative has presented itself. It cannot be mere animosity to Russia and South Africa. We enter into all sorts of commercial operations with the inhabitants of areas with whose politics we disagree. If there were general advantage to be gained by the retention of some use of gold in maintaining international monetary order, it would be frivolous in the extreme to discard it because one dislikes apartheid or the ruthless and brutal persecution of free thought—as I do most emphatically. In the last analysis, I fancy, the attitude which I am discussing rests simply on a belief that the U.S. can do better if its fiscal and monetary policies can be conducted without too much attention to external balance: and having regard to the comparatively small element in the G.N.P. of that vast area, one can see the point even if one does not agree with it, or, what is more germane to the subject of this lecture, even if one believes that it will not be easy in such circumstances to achieve orderly international financial relationships.

A prevalent fashion in some quarters is to believe that an effective substitute for gold as a medium of last resort in international settlements will be found in an extension of the system of Special Drawing Rights administered by the I.M.F. in its role of international clearing bank.

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Now let me say at once that I intend no disparagement of the Special Drawing Rights System. I have always had some difficulty in accepting the allegations of a lack of world liquidity in the past by which it has sometimes been supported. In my judgement, speaking generally, there has been *too much* rather than *too little* liquidity in the world since the war, as is surely witnessed by the general decline in the purchasing power of money. Indeed an unkind critic might say that the introduction of new instruments *at this stage* was like spending time devising an improved apparatus for central heating while one's house is in flames. But I still admire the ingenuity which brought about the circumnavigation of the more restrictive aspects of the Bretton Woods System; and I readily admit that, looking forward, the S.D.R. System may well have important functions to perform in this respect.

But the grand question is, would an S.D.R. System, *unbacked* by ultimate gold convertibility, and managed, not by some overriding federal political authority, but by the international institutions we now have, be sufficient to command general confidence? I doubt it, at any rate at the present point of international history. I really do know all the arguments against gold: I could repeat them in my sleep. But the plain fact is that a very substantial proportion of the population of the free world do not accept them and are not yet prepared to accept indefinite accumulations of any sort of inconvertible paper as a substitute for gold in their reserves. It is surely not without significance, even if it be capable of any number of burlesques, to observe the tenacity with which the central banks of the world, even the Federal Reserve Board, hold on to this allegedly superseded metal. The deplorable fact is, of course, that hitherto in world history, metal, although depreciating slowly, has held its purchasing power much better than any inconvertible paper system yet invented; and the common people in many parts know this and are liable to base action upon it. Sophisticated economists, of which I suppose I am one, may hope, as I certainly hope, that in the future we may do better and achieve greater stability of monetary values with less expenditure of capital and labour. But we deceive ourselves if we think that at the present time we carry all the world with us; and, in forming plans for practical action, we shall be wise not altogether to ignore what we regard as popular prejudice.

Hence, for the reason I have tried to develop, in the coming months, or years, of tough discussion about the future of

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international monetary relations, I should be surprised to see the rest of the world content to accept regulation on the basis of an *inconvertible* dollar standard. I should be surprised too, if we were to see in the near future an international system based on completely inconvertible Special Drawing Rights. If there is to be an international S.D.R. System, I suspect that it will still have to retain some element of convertibility and that, if the Americans are to play a part in such a system, they will have to descend a little from their dogmatic anti-gold high horse and be prepared to assume some obligations in this respect together with the other important powers. The alternatives are a continuation of uncertainty—which I judge to be not at all improbable—or the gradual emergence of a Western European bloc with a supranational money which, if sufficiently extensive, might perhaps float against the dollar—with a certain amount of 'dirty' intervention—without bringing the world to an end.

VI

This last possibility brings me to the final problem I wish to consider in this lecture—monetary arrangements in the Common Market.

Let me say at the outset that nowadays—this was not always so—I am a Common Market man. This is not because I think that it will bring about an economic miracle in the affairs of this country; on the contrary, although I think the disadvantages of being left out would be cumulative and the potential long-run benefits of being in considerable, I think that prediction of the short-run economic effects is difficult; and I certainly think that the preposterous agricultural system is a very high price to have to pay. I am a Common Market man chiefly for political reasons. I think the Americans are bound sooner or later to cease to regard their cities as expendable for, let us say, the continuing freedom of West Berlin. I am sure that if the states of Western Europe cannot create some integrated political and military union, they will be picked off one by one as the Greek city states were by superior imperialistic power. I also happen to think that the civilization of the West, with its hitherto unique potentialities of freedom and progress, is something which is worth saving and worth protecting by an adequate political and economic organization. I think that people who are blind to this aspect of affairs are burying their heads in a xenophobic and nationalistic sand.

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That being the end, I am in no mood to jib at the means; and in the final analysis I am clear that an integrated Europe should have a common monetary system. If I look a quarter of a century ahead, I certainly feel that if there does not exist by then something like a Federal Reserve System for Western Europe, the momentous experiment on which we are now embarked will have failed, and we shall still be exposed to all the dangers of a disintegrating nationalism altogether inappropriate to modern creative techniques or modern means of destruction. By that time the existence in a United Western Europe of different moneys exchanging at unpredictable rates of exchange would be as incongruous as similar arrangements within the United Kingdom at present.

But the immediate problem is in the present, not twenty-five years hence. And here, perhaps greatly to the surprise of some of you, I would urge a certain degree of caution, not, I hope, unallied with constructive imagination. I think that those who believe that the time is ripe for complete monetary integration run grave danger of bringing into discredit the achievement of arrangements which they, and I, think intrinsically desirable. This for two reasons.

First, I think we deceive ourselves if we believe that the states involved will be prepared to surrender their monetary autonomy until there has taken place a great deal more political and economic integration. No government exposed to the danger of military emergency can afford to give up its right to create the financial reserves which may be necessary unless it is absolutely assured of the existence of defence arrangements which exempt it from that responsibility. Few governments in the modern world would be prepared in peace time to limit their rights of financial manœuvre in respect of regional relief policies, if they were not assured in some way of the existence of supra-national agencies which would assume the essential burdens. It is futile to expect modern governments to accept complete monetary integration in the absence of a much fuller degree of consolidation of political responsibility than exists at present.

Secondly, and this is a much more down to earth practical consideration, I submit that to fix rates of exchange or conversion ratios into a new money until there is reasonable certainty that inter-regional rates have some sort of equilibrium relation to one another is to invite trouble—I have already recalled the wellnigh catastrophic results in this country of the fixing of a wrong parity in 1925. Moreover, so long as there are

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independent sources of money supply capable of yielding in one way or another to internal pressures, so long there will exist the possibility that expenditure structures in the different areas will be forced into inappropriate relations with one another if rates of exchange remain fixed; and if there exists no possibility of adjustment, then serious consequences are liable to follow. Suppose, for instance, that after any of the French inflations since the war there had been no means of changing the rating of the franc, clearly the internal development of that country would have suffered severe dislocation. It is quite true that if, in a fully integrated area with only one money, there were in some parts cost influences which brought about a rate of increase of incomes there greater than were occurring elsewhere, there would be likelihood of trouble. But that would be a possibility that had to be lived with—to set up different moneys for each different industrial or geographical group liable to this trouble would eventually involve an economic *reductio ad absurdum*. But to force on areas, not yet otherwise fully integrated, a permanent system of fixed exchanges, or a common money introduced at inappropriate conversion ratios, is to run unnecessary dangers.

For these reasons, I hope very much that, in conversation with our Common Market partners, the British representatives will resist premature rigidity in this respect. I do not abate one jot my belief in the ultimate desirability of a common European money and a common credit system. But, in the short run, the better may be the enemy of the good: and it is well not to risk our present degree of unity by forcing the pace before we are ready. Especially in the disgraceful conditions here, into which the policies of successive governments have brought us, it would be folly to give pledges about the rate of exchange which we may be unable to honour.

This does not mean that I favour complete inaction. Complete uncertainty regarding rates of exchange and complete independence in allaying them may easily be fatal to the very fragile degree of unity which we have as yet succeeded in establishing. I would put very little money on the stability of existing arrangements in the Community if a complete absence of common monetary arrangements were to continue. But, in my judgement, what is needed, here and now, is not any rigid commitment to existing or finally established rates but rather a gradual approach to greater unity *via* the creation of clearing arrangements and the provision of rules of procedure for negotiation of changes in rates, if persisting imbalance makes them necessary.

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With representatives of only nine states of more or less homogeneous habits and outlooks present, grown-up conversation about such matters would not be exposed to the difficulties which have beset the operations of the I.M.F. Hence I welcome last week's announcement of the creation of a European Monetary Union presumably with aims of this sort: and I cherish the hope that the use of a Common Market unit of account which has been adumbrated may prove the germ from which eventually a Common Market medium of exchange may evolve.

VII

May I conclude this long lecture by a very brief recapitulation? I argued first that the international monetary problem springs essentially from the existence of independent centres of money supply which at fixed rates of exchange are liable to get out of step with each other. I argued that this difficulty was not to be solved by a system—or rather absence of system—of floating rates all round: such a state of affairs would either prove self-destructive or it would breed uncertainty, confusion, and friction. This led me to a survey of the background, objectives, and deficiencies of the so-called Bretton Woods System under which we have lived since its inception after the war until its partial breakdown in 1971. I then proceeded to a discussion of the possibilities of reconstruction, dwelling particularly on the difficulties created by the attitude of the United States administration to dollar convertibility and the use of gold as a medium for international settlements. Finally I turned to monetary arrangements within a united Western Europe and, while endorsing the desirability of the eventual goal of complete monetary integration, I explained the grounds for caution in the early stages of approach.

I am sure that in covering such a wide field, I may well have used arguments that are invalid and made recommendations which are inexpedient. It is very hard to be right in these difficult matters. I would urge only as justification for my choice of subject its very considerable importance. International monetary equilibrium is not the only ingredient in healthy international relations, any more than a good digestion is the only prerequisite for a happy life. But it is an essential ingredient nevertheless; and past experience shows us that if it is not achieved, all sorts of other more interesting and important things may go badly wrong.

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