NOT FOR RELEASE BEFORE
3 p.m. E.S.T. February 3rd, 1969

REMARKS OF LOUIS RASMINSKY
GOVERNOR OF THE BANK OF CANADA
AT THE ANNUAL BANQUET OF THE OVERSEAS BANKERS CLUB
AT GUILDHALL, LONDON,
MONDAY, FEBRUARY 3RD, 1969

Remarks of Louis Rasminsky, Governor of the Bank of Canada,
at the Annual Banquet of the Overseas Bankers Club,
at Guildhall, London,
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My first words, in replying to the toast to the guests of the Overseas Bankers Club which has just been proposed in such pleasant terms by the President, Mr. John Thomson, must be to express our pleasure at being here on this very fine occasion. I am sure that in the case of my fellow guests the pleasure is unalloyed by any baser elements such as apprehension. I cannot say as much for myself. I am, of course, fully conscious of the great honour of being asked to speak at what has become a very important occasion in the London banking year and of sharing the platform with such distinguished company -- the Chancellor of the Exchequer, the Governor of the Bank of England, and the Lord Mayor of London -- but I am also acutely aware that there is little that I will be able to say that is new to so eminent a group as is gathered here tonight.

When I was trying to decide on the theme of my remarks, I considered for a few moments the possibility of talking about Canada and telling you something about the matters that are concerning people there. I was rather encouraged to think along these lines by the long association that Canada and Canadian banks have had with the City of London. The first Canadian bank came to London in 1870, only a few years after the birth of Canada in its present form. When it opened its doors here, there were (according to the list recently published in The Banker) only 8 foreign banks in London. By 1920 there were 5 Canadian banks in London, and the total number of foreign banks had reached about 30. Since then nearly 100 more banks from abroad have set up business here. The fact that many foreign banking institutions should have decided to join this great financial nexus during the past five years in spite of the difficult period this country has been going through is an indication of the continued importance and vitality of the City of London. This surely reflects the conviction, which I share, that London continues to have a great and constructive contribution to make in world financial matters.

As I have said, I had thought of talking about Canada tonight, but when I reminded myself that I am responding to the toast on behalf of two or three hundred guests from the continent and elsewhere I gave up the idea as inappropriately nationalistic for the occasion.

Instead, I shall say something about the international monetary system. Many of you may feel that this choice of subject shows more courage than wisdom. The international monetary system has been very much in the news recently, and that in itself is of course bad news. Since last November it has scarcely been possible to open a newspaper or an economic publication, including some very respectable ones, without reading that the international monetary system is on its last legs, that the edifice created at Bretton Woods is crumbling, that it must be substantially reconstructed. Some add that when this is done, the central bankers of the world must in no circumstances be permitted to have anything to do with operating it since they have made such a botch of things in the past.

If this diagnosis -- to use a very dignified term -- is right, then I am afraid that I stand condemned on two counts. I am, if you will forgive this autobiographical detail, one of the surviving babes of the Bretton Woods and had a hand in drafting the Articles of Agreement of the International Monetary Fund. I have, moreover - there is no use trying to conceal it -- been a central banker for the past twenty-five years.

Yet I do not, in truth, feel burdened down by a heavy load of guilt. Dryden said that "Secret guilt by silence is betrayed", and I am prepared to talk about the international monetary system. I must immediately add two things, lest I be suspected of complacency or innocence. The first is that if in 1944 we had had at Bretton Woods the benefit of the experience of the next quarter of a century I cannot believe that we would have drafted every article of the Fund Agreement precisely in the way we did. The second thing I want to say at once is that the present state of international monetary affairs is not one that gives anyone cause for self-satisfaction. During the past 15 months we have come through a succession of dramatic crises -- the culmination of the long travail of sterling in its devaluation, the rush into gold and the establishment of the two-tier system, and the massive speculation in favour of the German mark and against the French franc. In the minor leagues, we had an exchange crisis of our own in Canada a year ago. Not unnaturally, the problems of the major currencies have raised the question whether there is not some change in the agreed international financial arrangements which would spare the world these periodic alarums and excursions. If there is such a change we should certainly try to make it.

The international financial system is not a static thing but a constantly evolving structure of agreements and arrangements based on the International Monetary Fund. Something very important happened at Bretton Woods in 1944, and that was that the world consciously took control of the international monetary system. There had, it is true, been occasional deliberate efforts before that time to affect the way the system worked -- I am thinking particularly of the Genoa Conference of 1922 which encouraged the development of the gold exchange standard -- but the Bretton Woods Conference and the establishment of the Fund marked the beginning of the systematic and continuous application of human intelligence to the evolution of the world's international monetary arrangements.

Taking it by and large, in spite of periodic spasmodic adjustments, I venture to think that the system has served the world well. It has accommodated the rapid recovery of Europe from the most destructive war in history; in the past ten years it has accommodated a doubling in the value of world trade and a growth of more than 50 per cent in the real output of the OECD countries.

The system as we know it today has shown substantial capacity to adapt to change in an orderly and constructive way. The latest and most impressive of these adaptations is the plan to amend the Articles of Agreement of the Fund to enable it to create the new Special Drawing Rights. This is designed to forestall a future shortage of international liquidity, and the powers now being given to the Fund will both permit and require conscious control of the amount of international liquidity creation. This is a truly historic advance, and I am sure that you share my satisfaction at seeing such a major step forward in co-operative common sense taking place before our eyes.

Co-operation in international financial matters is equally evident in many quarters outside the Fund. In the Organization for Economic Co-operation and Development in Paris, in the Group of Ten, and in the Bank for International Settlements in Basle, a great deal has been achieved in recent years. Quite apart from several constructive programmes of action which have emerged, there is today a degree of examination by the larger industrial countries of each others' financial policies and of their effects on other countries that would have been inconceivable a generation ago.

In the process of gradual change and evolution of the international monetary system which I have been describing the central banks of the world have played their part. A huge network of swap arrangements has been put in place through the constructive leadership of the Federal Reserve System of the United States, and other central bank credit facilities have been arranged either through the good offices of the Bank for International Settlements or directly by the central banks involved. These facilities now place very large sums at the disposal of monetary authorities to counter short-term capital movements. These sums could be greatly enlarged very quickly if there were need to do so, and consideration is currently being given to whether it would be preferable to deal with any special needs that might arise in the future by flexible ad hoc methods or by more highly structured standing arrangements.

May I remind you at this point that there is a clear economic philosophy underlying the Bretton Woods system and the companion initiatives which have taken place in the trade field since the end of the war. This philosophy is that the interests of all countries will be served by international consultation and co-operation in economic matters. The experience of the 1930's had revealed very clearly that effective international co-operation is not something that thrives without cultivation. If you want it you have to work at it. What the Bretton Woods system sought to do was to find the means whereby sovereign national states could build co-operatively a strong and expanding world economy to help them in achieving their economic objectives.

I make no apology for expounding these simple truths. For I feel that in a very real sense what we are confronted with today is the need to decide whether we are to go forward along these lines or whether we are to go off in another, more inward-looking, direction. The international monetary system is now under severe strain because several larger countries have failed to keep their own external payments positions within the bounds of what their own circumstances and the world's needs require. The general character of the present world payments imbalance can be easily stated. Some countries, notably Britain and the United States, whose currencies are held as reserves by other countries and who therefore have a particular responsibility for maintaining confidence at all times, have much weaker international payments positions than they should have. Some other important countries, notably Germany and Italy, have much stronger external positions than they need. This much commands widespread agreement. The controversial question is -- why have these imbalances grown so large and persisted so long?

Many answers are offered to this question. A number of them attribute the difficulty primarily to a lack of sufficient flexibility of foreign exchange rates under the Bretton Woods arrangements. According to these views, we should seek arrangements under which exchange rates would react quickly and automatically to any tendency of a country towards payments imbalance. A number of techniques have been proposed to permit this to happen; they vary all the way from a modest widening of the range within which exchange rates are free to move under the Bretton Woods Agreement to such extreme ideas as that governments should agree to stabilize not their exchange rates but their exchange reserves, and should indeed foreswear intervention in their exchange markets no matter what the circumstances.

As you know, the Bretton Woods system does not preclude the use of exchange rate changes in correcting payments imbalances, but it seeks to limit their use to circumstances of "fundamental disequilibrium". What this means is that countries in payments imbalance are first expected to seek to restore balance in their international accounts by adjustments in their domestic economic and financial policies. Only if it turns out that the restoration of external equilibrium in this way would be inconsistent with the maintenance of high levels of employment and real income or of reasonable price stability is a change in the exchange rate seen as appropriate.

The Bretton Woods approach to the determination of exchange rates is a very sophisticated one. It relies on the judgments of governments rather than on mechanical procedures. It follows from this that decisions to change or not to change a country's parity may exhibit admixtures, in varying degrees, of profound economic insight and political expediency. I would not wish to argue that this system was incapable of improvement, but I do not propose to discuss tonight the pros and cons of the various alternatives that have been advocated to modify or replace it. I limit myself to two general observations.

The first of these is that a country's exchange rate cannot be regarded as a matter of purely domestic concern by other countries. An exchange rate is a two-edged instrument; every exchange rate is shared by two currencies. Unilateral action affecting exchange rates is therefore unacceptable in principle. Countries must in their own interests regard the determination of exchange rates as a proper subject for international consultation and agreement.

My second comment is that no exchange arrangements, no matter how carefully thought out or theoretically perfect, can compensate for defects in national policies. All countries want stability in their external economic environment. If they are to have it, they must accept responsibility for achieving stability in their own external economic relationships. If countries manage their affairs in a way that maintains stability in their own international economic relationships, almost any exchange rate arrangements will work reasonably well. If they do not, no arrangements will work well. An important criterion by which to judge the relative merits of one exchange rate system as compared with another is this therefore: which system offers the greatest encouragement to governments to behave responsibly and sensibly in their domestic policies and in their international economic relations?

It will be evident to you by now that for my part I look mainly to better national economic policies rather than to new exchange rate techniques to make the international economic system work well and to provide solutions to our present problems.

I do not pretend that it is easy to manage a modern economy in such a way as to achieve and maintain both internal balance and external balance and to avoid complicating life for one's trading partners. However, I see no escape from the need to keep on trying. I am encouraged by my impression that there are, in fact, far fewer policy conflicts involved than is commonly supposed. Far more often than not, external imbalance in a country is due to internal imbalance in that same country. In any event it is a mistake to suppose that deficit countries have any real prospects of sustaining internal prosperity over any extended period of time without achieving a manageable external balance. To be sure, if by some magic a country were free to draw without limit on the resources of the rest of the world to further its domestic economic objectives, the situation would be different. But who thinks he knows how to make that kind of magic? Sooner or later, every country must achieve a sustainable external balance, and the longer this is put off the more disturbing internally will be the steps that ultimately have to be taken.

Why then have we not been more successful in recent years at developing national policies to ensure a continuous reasonable degree of equilibrium in international payments? A full answer to this question would require an assessment of the way in which both surplus and deficit countries have behaved, for both have a responsibility to make the system work. The simple answer for those of us whose payments positions have, from time to time, been on the weak side is that we have attached more importance to other things, without apparently realizing that sacrifice of some sort is involved in attaining them. Consider some of the ways these other priorities have expressed themselves. We have sought to enlarge public expenditures, including many expenditures for worthwhile purposes, without, however, being prepared to take the steps necessary to divert resources from other uses. We have sought to deploy positions of power around the world without, however, being prepared to back them up in real terms by imposing the necessary sacrifices on the domestic economy. We have paid ourselves increases in income without ensuring that we achieved proportionate increases in real output to spend the increased income on.

I have, as you will recognize, just been describing some of the many seductive faces that inflation wears. Expressions of concern about inflation sometimes draw the reply that we must choose between inflation and unacceptable rates of unemployment. I think we are today seeing more and more evidence that this is an illusion. The idea that a certain rate of inflation must be accepted more or less indefinitely as the price that has to be paid for keeping unemployment at some target level assumes that large numbers of people do not know what is happening to them when prices rise persistently. But people are not so foolish. They do observe what is happening and if it keeps on happening they develop an expectation of continuing inflation and adjust their behaviour accordingly.

The popular idea that it is easier for the authorities to manage the economy efficiently if they are prepared to be tolerant of some inflation is beginning to wear very thin. Tolerance of inflation, by breeding the widespread expectation of continued inflation, makes the job of demand management more difficult and less reliable. Fiscal and monetary restraints by governments and central banks in the interests of internal balance and external adjustment are offset by a reluctance of the public to hold money or claims on money. In North America, the highest interest rates in modern history produce disappointingly little effect on the demand for credit.

The vulnerability of this state of affairs is too obvious to need underlining. In my opinion the most important immediate objective of economic policy in many countries from both the domestic and the external point of view is to break the inflationary expectations that exist and to restore respect for the value of money.

Of course we must do this without precipitating a world-wide deflation from which all would suffer. The risk of this is reduced in that, fortunately, not all countries are in the same boat. While some have the responsibility of restraining inflationary tendencies in their economies, other countries which are in surplus have the equally great responsibility of encouraging an adequate degree of economic expansion and capital export.

Mr. President, I have come to the end of what I have to say. Let us by all means bring our analysis of the problems of the international monetary system to a focus. If further evolution of the Bretton Woods arrangements is indicated, let us seek to achieve a consensus on what is required and how to achieve it. But let us use the existing well-tried channels of continuous consultation rather than dramatic conferences that risk disrupting the world's currency markets. And above all else let us not lose sight of what we are really after. What we basically need is more responsible and realistic national economic policies which are effectively meshed with each other in this growingly inter-dependent world.