The Keynes-Triffin Plan on International Liquidity

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The orthodox habit of maintaining international reserves in gold alone has been gradually given up in favour of holding certain national currencies.

The stability of the exchange rate now mainly depends on the dollar and the sterling, the two key currencies used for accumulating international reserves. A weakness in either, arising from domestic or international pressures, may consequently destroy the delicate fabric of convertibility.

This happened in the 1930's and may happen again.

A radical solution is to create a new international organisation, an international central hank, to which would he handed over the foreign exchange reserves of all countries.

This is the Keynes-Triffin Plan on International Liquidity. The major obstacle to its implementation would be the' reluctance of countries to give up their sovereignty over reserves. But it can he considered as a proposal to set the ball rolling for future negotiations.

CURRENTLY the dollar is under severe international economic pressure. Countries holding a large stock of dollars as currency reserves are gradually converting idem into gold. Consequently, the United States balance of payments reflects a steady flow of gold out of the country. The gold stock has declined to very near the "safe limit" of $17,000 billions. Even in the Loudon Cold Market which supplies practically 80 per cent of the world's total requirements, the price of gold has for some time now. shown a consistent premium over the officially fixed dollar/gold parity of 8.15.00 per ounce of fine gold.

This development has brought into sharp focus the problems of international monetary policy. Before considering the problems one has to lay down the goals that are nought to be realized. They may be considered to be three in number :

(a) the maintenance of world prosperity at higher rates of growth;

(b) the return to the classical concept of free world trade and

(c) maintenance of discipline in the foreign exchange markets which includes the objective of full convertibility.

Exchange Reserves

These objectives are in a sense, pure abstractions and their attainment, by that token of measurement can be considered to be problematic. In spite of this, economists strive for their realization in the closest possible degree, if not absolutely. Professor Robert Triffin of Yale is one such individual. This article reviews his current work "Cold and the Dollar Crisis" in this connection.

He feels that the above objectives cannot be realised under the existing international monetary arrangement. He feels that world prospers ly cannot grow continuously because it suffers from a shortage of international liquidity. Just like an individual, the nation also requires cash for conducting international transactions. This usually takes the form of exchange reserves. It can be postulated, that when economic prosperity increases, the demand for exchange reserves would also get up. If this higher demand is not satisfied, the world would be exposed to the dangers of a slump.

Empirical evidence can be mustered in support of this hypothesis. The failure of convertibility in the 1920's and the consequent currency disparities led to a contraction in world liquidity. This resulted in a crisis of general confidence in the gold standard mechanism and the Great Depression was the consequence. The second near-disaster was averted in 1958. The "German miracle" and the rapid recovery of the OEEC countries brought about an imbalance between the demand for international liquidity and its supply. Fortunately, by fortuitous circumstances, a crisis was averted by a sizeable disequilibrium in the balance of payments of the United States, to the extent of $1.5 billion in that year alone. A further deficit of $3.5 billion in 1050 and an expected deficit of another $3 billion in 1960 have for the time being removed the threat of a depression.

This development has. however, raised two new problems. For some time past (the orthodox habit of considering gold alone as a precondition of holding international reserves, has been gradually given up in favour of holding national currencies as international reserves). This serves to supplement gold as a form of international reserves holding. Primarily, only two key currencies are being used for this purpose, namely the dollar and the sterling. Even in their case, this is done very haphazardly, so that it poses a perpetual threat to the economic well-being of that country whose currency is held for this purpose. The danger is increased further since the currency acting as an international reserve loses its independence in terms of domestic monetary policy. The action of monetary authorities is now subject to the dual loyalty of domestic and international considerations which, in a majority of cases, is likely to be conflicting rather than complementary.

The Dangers

Apart from the impingement on the sovereignty of national economic policies, the use of key currencies as reserves affects the system of convertibility which is the second modern problem. Exchange rate stability and discipline in the exhange markets has been assiduously realized to a fairly large degree under the auspices of the International Monetary fund. However. the stability of exchange rates depends mainly upon the dollar and the sterling, the two key currencies used for accumulating international reserves. A weakness induced in either, be domestic or international pressures, may destroy the delirate fabric of convertibility. This is what actually happened in the 1930's and may happen again in future. A loss of con-

fidence in the exchange markets would lead the world hack to trade restrictions, multiple currency prar-lices bilateral trade arrangements and economic autarky. Adequate international liquidity is. thus, vital to the realisation of three objectives of world prosperity, tree trade and convertibility. Professor Triffin feels that there is a dearth of liquidity in the world.

The key concepts employed by Professor Triffin for this purpose are two. In the first instance, the rate of growth of industry and trade for the world as a whole is derived from time series data beginning 1876 (Tab. 1). It shows that on an average, the annual rate of growth of world industry and trade on a compound basis has been of the order of 3 per cent. What has been the corresponding demand for international reserves ? This introduces the second concept of the ratio of gross reserves to imports. Table 2 gives the ratio for certain selected years over the period 1928-57. The average ratio for the world excluding the US during the period comes to 34 per cent.

Demand for Reserves

Assuming that the long term rate of growth of Made and manufactures and the need for reserves remain roughly the same as hitherto, we can predict the future demand for reserves. If as in the Fund Study, we take the years 1956-66. then the gross reserves required are of the order of $19 billion. If. however, we assume that countries with very large reserves (for example, U S A. West Germany. Venezuela and Switzerland! will not most probably add to their liquid reserves. then the net demand will he $8 billion. To presume a single unique rate of growth is good for the long term, hut fairly dangerous in the short period. During the latter phase, we have, to provide ourselves with a spectrum of possibilities It is more realistic to assume if recent experience is any guide that the growth rate of world trade and manufactures will he over 3 per cent. For example, during the period 1950-57. the average rate of growth has been 6.3 per cent per annum. If. therefore, we assume a 1. 5 or 6 per cent rate of growth, then the required reserves (in terms of our above qualification) rise to 810.1. $13.7 and $21.1 billion, respectively.

Who is going to supply this liquidity Normally, gross reserves are a sum total of gold and foreign currencies and foreign assets. If the increment in the stock of world gold is assumed to be of the order of 1.5 per cent per annum, then gold alone for the decade ending 1966 will he supplied to the tune of $7 billions, or just enough to guarantee a 3 per-cent rate of growth on our assumptions. Any higher rate of growth will experience a gap in international liquidity which will he met by an increase in the percentage of foreign exchange held as international reserves. for example, the percentage of foreign exchange to total reserves would rise sharply from 15 per cerl. to 57. 65 and 71 per cent, if rates of growth in world trade are assumed to be of the order of 3.4. 5 and 6 per cent, respectively.

This trend is extremely disquieting for the realisation of the objectives of international monetary policy. Says Professor Triffin. "It seems extremely unlikely that the growth of dollar or sterling balances can provide a lasting solution to the inadequacy of gold production to satisfy prospective requirements for international liquidity in an expanding world economy" (p 57). For the time being, the issue has been avoided, but time is "running short", and "the danger is increasing daily" . Any '"further inaction and complacency may lead to a repetition in a different form of the 1931 collapse of |he gold exchange standard" (p 58)

Keynes-Triffin Plan

In view of this grave threat, the solution offered by Professor Triffin is equally radical. He proposes the ''internationalization of the foreign exchange component of world monetary reserves" (p 10), This is to be accomplished by creatinig a central

Table 2 Gross Official Reserves (Gold and Foreign Exchange) as per cent of Imports

Year	World	World excluding U S
1928	41	27
1937	109	49
1948	86	36
1950	86	46
1951	64	32
1952	65	31
1953	65	34
1954	68	35
1955	61	32
1956	57	30
1957	54	27
Average over the period	69	34

Source: Based on data in IMF Ibid. Appendix Table 2 p 100-101.

Table 1 Average Annual Rates of Growth of World Trade and Manufactures

(per cent compound basis)

	Period	Trade: Primary products	Trade: Manufactured products	Manufacturing activity
From	1876-80 to			
	1901-05	3.3	2.8	4.1
	1913	3.4	3.3	4.1
	1926-29	2.6	2.4	3.5
	1930	2.6	2.2	3.3
	1936-38	2.3	1.8	3.5
From	1901-05 to			
	1913	3.5	4.7	4.2
	1926-29	2.0	2.1	3.1
	1930	2.0	1.7	2.7
	1936-38	1.5	1.1	3.1
From	1921-25 to			
	1926-29	6.3	7.1	6.8
	1936-38	2.2	1.3	4.4
From	1938-48 to	0.0		3.7
	1948-56	7.5		6.1
	1950-56	6.5		5.7
	1950-57	6.3		5.1
	1951-57	5.4		5.0

Source: I M F: "International Reserves and Liquidity" (p 70) Washington 1958.

bank for central banks, a new organisation to be brought into firing by modifying the International Monetary Fund. Since the proposal has evolved out of the Keynesian recommendations for a Clearing Union, it has come to he popularly railed the Keynes-Triffin Plan (K T Plan).

The articles of the K T Plan would provide inter alia, for an unrestricted opportunity for the full clearing of each country's bilateral credit and debit, balances. It would also involve handing over of all international reserves as Fund deposits to the modified Fund. The present quota system would thereby be abolished. As the success of this measure will depend upon the cooperation of the participating countries. Professor Triffin feels that full compliance of the above provision may not invoke a favourahle response. He. therefore, proposes that initially members may he asked to deposit with the Fund only a certain portion (say 20 per cent l of their gross monetary reserves.

On the basis of a 20 per cent initial deposit. Professor Triffin assumes the Fund resources would he around $11 billion with a possibility of annual increase by a constant coefficient of 0.20 caused by future rise in members" reserves. However, only half of the above amount could he lent out. since a country cannot be a debtor and a creditor at the same time. This. therefore, restricts its. lending capacity. A possible way out suggested by Professor Triffin is to raise the initial percentage of deposits or issue medium-term gold certificates payable either in gold or in excess Fund deposits. Alternatively. he suggests an imposition of higher deposit requirement upon that pinlion of each member's reserves which exceeds the average ratio of world monetary gold to world imports.

Full Convertibility

The accumulation of credit balances in the form of deposits with the. Fund carries with it a right to full and absolute convertibility into any currency or gold on demand by creditors. This will enable participating countries to insure themselves against risks of exchange fluctuations, inconvertibility, blocking, or even default. It will also enable them to count the Fund depo--ts as a normal and variable component of their monetary reserves required for gold cover purposes, wherever legal requirements still persist.

The grant of credit facility to member countries is not to follow the automatic principle. This is to safeguard the possible inflationary bias in the new scheme. This objective, can he achieved in two complementary 'safe' ways. The first is to impose a unanimity clause on all important lending decisions, or a qualified vole of. say two-thirds, three-fourths, or four-fifths majority. The second may be to limit the lending capacity of the fund. This can be achieved on tin- basis of an

Martin Burn Limited

Notice

THE Annual General Meeting (being the Fifteenth Ordinary General Meeting) of the Shareholders of Martin Burn Limited will be held on *Monday, 27th March, 1961, at 12 noon at the Registered Office of the Company*, 12, Mission Row, Calcutta, to transact the following business:

1. To receive and adopt the Audited Accounts for the year ended 30th September, 1960, and the Directors' and Auditors' Reports thereon.
2. To declare a Dividend.
3. To appoint Directors.
4. To appoint Auditors and to fix their remuneration.

AS SPECIAL BUSINESS.

(A) To consider the re-appointment of Mr. Saradindu Gupta as a Managing Director of the Company for a further period of four years with effect from the 1st May, 1961 and in this connection to consider and if thought fit to pass with or without modification the following resolution which will be proposed as an ordinary resolution:—

"That subject to the approval of the Central Government pursuant to Section 269 of the Companies Act, 1956, this meeting approves the re-appointment of Mr. Saradindu Gupta as a Managing Director of the Company with effect from the 1st May, 1961, on the terms and conditions contained in an Agreement dated the 29th December, 1960 and made between the company of the one part and Mr. Saradindu Gupta of the other part a copy of which was laid on the table and signed by the Chairman for the purpose of identification or on such other terms and conditions as may be agreed upon with the Central Government and accepted by Mr. Gupta."

(B) To consider the appointment of Sir Narayan Raghavan Pillai as a Managing Director of the company for a period of four years with effect from the 1st March, 1961 and in this connection to consider and if thought fit to pass with or without modification the following resolution which will be proposed as an ordinary resolution:

"That subject to the approval of the Central Government pursuant to Section 269 of the Companies Act, 1956, this meeting approves the appointment of Sir Narayan Raghavan Pillai as a Managing Director of the Company with effect from the 1st March, 1961 on the terms and conditions contained in an Agreement dated the 17th day of February, 1961 and made between the company of the one part and Sir Narayan Raghavan Pillai of the other part a copy of which was laid on the table and signed by the Chairman for the purpose of identification or on such other terms and conditions as may be agreed upon with the Central Government and accepted by Sir Narayan Raghavan Pillai."

The Ordinary Share Register and Transfer Books of the Company will be closed from 13th to 27th March, 1961, both days inclusive.

A member entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and vote instead of himself and a proxy need not be a member.

By Order of the Board,
A. G. Gidley
Secretary.

Calcutta,
27th February, 1961.

NOTE: The Dividend, if sanctioned, will be paid on or after 14th April, 1961, to those shareholders so entitled whose names appear in the Company's Register of Members for Ordinary Shares on the 27th March, 1961, or to their mandatees. No application for dividend warrants will be necessary.

AN EXPLANATORY STATEMENT as required under the Companies Act, 1956, has been forwarded to the members of the Company.

equilibrium theorem, creation of credit "sufficient to preserve an adequate level of international liquidity'.

The assets acquired by the modified Fund will generally consist of three elements : gold, net creditor claims already accumulated with the Fund, and liquid or semi-liquid foreign exchange holdings. The first type of asset, gold, creates no problem. But in so far as liquid assets are concerned. Professor Triffin suggests that the Fund should be empowered to sell this paper in an orderly manner. This can be done by liquidating them at an annual rah of. say, 5 per cent. Likewise, the sale of currency reserves can also be conducted on the assumption of a stable foreign exchange market.

Given the above modifications, the problem of liquidity is likely to be successfully solved. The major obstacle to the scheme, perhaps, steins from the conservative and cautious attitude of world central bankers.. They would be chary to give up a part of their sovereignty over reserves. The K T Plan can, nevertheless be considered as a proposal to start the ball rolling for future negotiations. The world no doubt needs a central bank if blind economic forces are not to dominate 'he international monetary mechanism.