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Toward a World Central Bank

by Karl Blessing, Frankfurt/M.

This article is a commentary by the former president of the Deutsche Bundesbank given at the annual meeting of the Per Jacobsson Foundation in Basle at the 14th September 1970. It relates to a comprehensive lecture by Mr. William McChesney Martin, Jr., who examined ways and means of the evolution of a world central bank.

We all know only too well the deficiencies of the present international monetary situation: balance-of-payments disequilibria and world-wide inflation. Part of those disequilibria has been removed lately by the British and French devaluations, together with the corrective measures taken in those countries, and by the German revaluation. But inflation is still going on and has even accelerated, and the US balance-of-payments problem is still unsolved. The risks and uncertainties of the gold exchange standard, which has become more and more a dollar standard, still exist. The forces creating balance-of-payments disequilibria are still at work; price and cost disparities may re-emerge at any time and the working of the adjustment process remains highly unsatisfactory.

Conflicting National Interests

International co-operation and the activities of the international monetary institutions could not prevent those deficiencies, and even a full-fledged world central bank could only do away with them if it had full power to compel national authorities to abandon inflationary policy and to apply a better balance-of-payments discipline. In spite of the willingness of nations to co-operate there are still conflicting national interests and different targets aimed at by different governments. Some governments put more emphasis on full employment and growth, others on price stability.

Without a fundamental change in philosophy and behaviour there is not much hope either of improving the international monetary situation or of making more progress towards a world central bank. In theory, one might imagine a world central bank being established or the IMF being transformed into such a bank, in order to enforce better monetary discipline. But this could only be done if national freedom of action and national sovereignty were restricted to an extent which would in my opinion not be accepted by national

governments and parliaments, at any rate not in the present state of affairs.

Tasks of a World Central Bank

The proposals for creating a world central bank or for transforming the IMF into such a bank usually rest upon an analogy drawn between a national central bank and a world central bank. The task of a national central bank is to manage monetary and credit policies, to supervise the domestic banking system, and to act as a lender of last resort. Those who advocate a world central bank obviously think that such a bank would do for member countries and their central banks what each national central bank now does for its own country and its own banking system. A world central bank would therefore have to manage the international monetary system and the international money supply. It would operate as a lender of last resort for national central banks, if they were in need of foreign exchange to cover a balance-of-payments deficit.

In doing so it would have to apply very strict lending rules and it would have to exercise a strong influence on the economic and financial behaviour of the borrowing countries. Otherwise, the borrowing countries might fail to repay their debts later on because they did not achieve a balance-of-payments surplus. The influence of a world central bank would certainly have to be far greater than the influence now exercised by the IMF when countries are drawing on the credit tranches. In fact it would have to lay much greater emphasis on price stability. Its lending rules would have to take into account the experience of the post-war period when the danger of excess demand and inflation was far greater than that of recession and unemployment. To reach international agreement on this issue would probably not be easy. But even if it were possible to agree on strict lending rules the managing

board of the world central bank would be put in a difficult position. Could or would the managing board cease to grant credits to a member country if its recommendations for corrective action were neglected for one reason or another? The experience of the Fund shows how difficult it is to bring countries to take corrective measures. Could a world central bank achieve more than the Fund? And what would happen if the managing board came to the conclusion that the exchange rate of a certain currency was no longer realistic? Could the board compel the government concerned to alter the parity? The Fund has no power to propose a change in parity. If a world central bank were given this power, would its advice be followed?

Tremendous Political Difficulties

One cannot neglect the fact that there are considerable differences between the operations of a national central bank and a world central bank. A national central bank operates within the sovereign authority of only one government. Even if it is independent it has to support the financial and economic policies of its government. A world central bank would operate as a creature of many sovereign governments. Its managing board would often hold views about the appropriate economic and financial policies in a particular country that were different from the views of the central bank and the government of the country concerned. Therefore, member countries' power to act on their own would have to be curtailed. Of course even now a country has to take into account the repercussions of its actions on other countries. But there is a considerable difference between a country adjusting individually on its own initiative to the outside world and a country adjusting on the recommendation of, or under pressures from, an international body. One might argue that the object of creating a world central bank is precisely to end the sovereign right of individual countries to expand their domestic money supply excessively and to permit inflationary developments. But the national political difficulties involved here are tremendous.

Even in the Common Market, where a firm political desire to integrate exists, it is extremely difficult to co-ordinate and harmonise the different trends in member countries as regards total demand, prices and balances of payments. A monetary union of the Common Market countries as the ultimate economic aim can only be achieved if the member governments pool a great part of their sovereignty in some form of central authority. The customs union which has already been achieved is not sufficient for the attainment

of that aim. Without a far-reaching co-ordination and harmonisation in the economic, financial and credit fields no progress towards such a monetary union can be made. Of course, in theory one could establish a kind of Federal Reserve Bank of Europe right now, with full power to enforce integration and co-ordination as it is sometimes suggested. But such a procedure would involve too much political dynamite. It would probably not speed up the integration process and might even blow it up. It has therefore been agreed to proceed in stages by doing away step by step with national divergencies in the economic, financial and credit fields. It is obvious, for instance, that deficits and surpluses in the national public budgets and the manner in which they are financed influence the monetary situation of the whole community and cannot be left entirely to the discretion of member countries. In the Common Market we have even come to the conclusion that a certain measure of understanding on wages and incomes policies is essential.

International Liquidity

All these difficulties confronting us in the Common Market would also confront a world central bank. In some respects the difficulties might be less because the integration process would not have to go so far as in the Common Market. In other respects they would be even greater because a world central bank would have to deal not only with a restricted number of highly industrialised countries but also with a great number of less developed countries.

Even the management of international liquidity involves great differences of opinion and wide areas where judgement is required, as we know from extensive discussions in the past. The need for international liquidity depends very much upon the efficiency of the adjustment process. If exchange rates are realistic and the disequilibria in the balances of payments are modest, less international liquidity should be needed than in the reverse case. This is why those who advocate greater monetary discipline do not favour large increases in liquidity, while countries in chronic deficit generally take the opposite view. My personal view is that we did not have too little but rather too much global international liquidity in the past. Otherwise creeping inflation in the world would not have been as persistent as it in fact was. Others seem to regard the creation of Special Drawing Rights at the rate of 9½ billion dollars over the years 1970, 1971 and 1972 as insufficient. It has already been suggested that the amount of Special Drawing Rights to be created should be considerably increased for the years from 1973 onwards. In my opinion, in-

ternational liquidity has been insufficient only for countries in chronic deficit but by no means from a global point of view. In the future, it might be different. But for the time being we are suffering not from a shortage of international liquidity but from an inadequate adjustment process. Balance-of-payments deficits should be removed as soon as possible either by taking internal corrective measures or, if necessary, by altering the parity. They should not be facilitated and prolonged unduly by allowing the deficit countries to finance their deficits directly or indirectly for too long a period.

Regulation of Reserves

The concept of international liquidity has never been precise and is even less precise nowadays than it used to be. For instance, swap lines certainly represent potential international liquidity. The same is true of the credit lines in the Fund. And what about the Euro-dollar market? It would be wrong to relate international liquidity exclusively to official reserves. There is an inter-relationship between commercial and central banks. Although the Euro-dollar market may not affect the total of international liquidity, it functions as a pool of international liquidity, whether private banks or central banks hold the dollar balances. What kind of liquidity, therefore, should the world central bank attempt to manage? It would certainly have to rationalise the whole reserve-creating process and to exert an influence upon the behaviour of reserve-creating countries. Here, I am in complete agreement with Mr. Martin. I also agree with him that the Euro-dollar market should somehow be supervised, although I do not know how this could be achieved in practice.

It has often been said that the creation of Special Drawing Rights was the most important step so far towards a world central bank. It is claimed that the SDR system provides the means for a collective control over the supply of international liquidity. This sounds very convincing in theory. I can as yet, however, not see that it will fulfil this expectation so long as, in addition to SDRs, dollars and other forms of international liquidity are being created in an uncontrolled manner. For the time being the IMF cannot be regarded as a real regulator of the total volume of reserves.

There are also those who say that the international monetary system has been transformed into a dollar system in recent years, meaning that the Federal Reserve Board in Washington is already functioning as a kind of world central bank. So long as deficits in the balance of payments of the United States provide the rest of the world with additional liquidity, this conclusion

is not wrong. In fact, in this respect the Fed possesses all the attributes of a supranational bank. We have to bear in mind, however, that the Fed is managing the American money supply with an eye to the liquidity needs not of the world as a whole but only or mainly to the needs of the American economy. The changes in dollar holdings outside the United States are the result not of a deliberate planning of international liquidity but of whatever the outcome of the United States balance of payments happens to be.

Some of the functions of a world central bank are already being performed. In view of conflicting national interests and of the different aims countries still pursue it would, however, be difficult to reach international agreement on a bank operating as a top central bank of national central banks with full power to supervise the international monetary system, to be solely responsible for the systematic management of the international money supply, and to operate as a lender of last resort with the right to enforce monetary discipline on member countries. It would therefore be wise not to strive for utopian goals but to try to make less dramatic progress within the already existing machinery. The IMF as an already existing institution would be best qualified to streamline and improve the present system. Other international institutions like the BIS could render a useful service too.

I cannot help feeling that in the past we have laid too much emphasis on technicalities and too little on monetary discipline. Even the most perfect institutions are of little value if there is monetary disorder in leading countries. No monetary system, however intelligently designed, can replace sound policies. Discipline begins at home. Let us try to put our own houses in order, let us try to get rid of inflationary practices and let us try to improve the adjustment process and the balance-of-payments situation. For the time being this is more important than discussions about reserves and liquidity.

Perhaps we should alter parities more often than in the past in order to remove disequilibria before they do harm to the whole system. I am, however, not a friend of floating rates, nor am I in sympathy with the idea of an automatic system of "crawling pegs", as it would weaken, rather than strengthen, monetary discipline. A slight widening of the band around parity might be useful, but is certainly not a remedy for our problems.

The dollar is still the leading currency of the world and the backbone of our monetary system, whether we like it or not. As things stand, a strong dollar means a strong system, and a weak dollar means a weak system, and a world central bank could hardly alter this state of affairs.