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Ian Shannon on International Liquidity | 5 pages

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Ian Shannon on International Liquidity*

This book is essentially a plea for a huge increase in the price of monetary gold, $100 per ounce being intimated to be perhaps the right price. The plea is based on two contentions: first, that a massive increase in international liquidity is the essential prerequisite to more rapid economic growth in the developing countries, as well as to an appropriate rate of technological change throughout the world;1/ and second, that this massive increase in international liquidity should take the form of gold, and be achieved by substantially raising its price.

Because the author seems to think it necessary to mention everything even remotely connected with his topic, it is difficult to summarize the substance of his argument. But in Chapter V, covering the technological aspect of the first of these two contentions, his underlying thought is that "technological change"2/ increases actual

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* A review, published in the Zeitschrift für Nationalökonomie, Vol. XXVI (1966), Number 1-3, of I. Shannon, International Liquidity: A Study in the Economic Functions of Gold. 143 pp. Melbourne--Canberra--Sydney: F.W. Cheshire, 1964. The review is reproduced here by permission of the publishers of the Zeitschrift für Nationalökonomie.

1/ The author also brings in, but almost as an afterthought, the argument that a substantial increase in international liquidity is necessary to international monetary stability. This argument is set forth in a separate (the penultimate) chapter, although on a basis which gradually merges with his economic-development case for such an increase.

2/ The reference to "technological change" in the chapter title serves as a roof over discussion of many forces or phenomena besides technological change, with varying degrees of relevance to it: the significance of differing natural-resource endowment for international trade; rising living standards; size of country and stage of economic development; changes in terms of trade; and many others.

or potential imbalance in international payments, and thus the need for international liquidity.[3/] Much of the discussion in this chapter strays into the territory of the next, on the economic-development aspect, which is clearly and perhaps rather naturally the author's main preoccupation.

The author's central ideas in Chapter VI are as follows: economic aid to developing countries needs to be increased; in general, the main aid-providing countries realize this; but these countries tend to be fearful that increased outflows of untied aid might cause serious deterioration in their balances of payments; thus the aid problem is essentially a transfer problem; the most practical way to solve this problem is to provide for the financing of these transfers if necessary, during the long period--estimated at ten to twenty years--in which such transfers and their financing might be needed, out of large-scale increases in the reserves of the advanced countries.

The author's defense of his second main contention--that the right way to achieve the massive increase in international liquidity alleged to be needed is to raise the price of gold--is based mainly on the following views: that the increase in international liquidity which is needed is in "owned" reserves rather than in credit lines;

3/ The discussion in Chapter V overlooks a number of forces tending to reduce the magnitude of international imbalance. (Some of these are cited in Bent Hansen: International Liquidity. Central Bank of Egypt. Lectures. Cairo: 1962, pp. 8 ff.) There is, however, an emerging consensus that while future reserve needs cannot be predicted accurately, they may indeed exceed availabilities unless action is taken to prevent such a development.

economic aid to developing countries. Political and other considerations in the industrial countries are very important obstacles, as is at least suggested by the fact that even countries in chronic balance-of-payments surplus have not exactly rushed to enlarge their aid offerings in consequence. Second, even if it were appropriate to regard the problem of aid to developing countries as primarily a transfer problem, aid-providing countries would be unlikely to view the possibility of financing such aid out of a substantial increase in their reserves as a solution of that problem. One reason is that such countries could not safely assume, as does our author, that the need for large-scale assistance to developing countries would end in ten to twenty years (or that their reserves would be increased again if it did not).

A key point which seems to have escaped Mr. Shannon is that it is precisely the kind of thinking he has displayed in this book that is responsible for much of the resistance of surplus countries to various plans and proposals for enlarging international reserves or other forms of international liquidity. The root idea of this kind of thinking is: the whole thing can be painless, a net benefit to all concerned. But is it painless? The proposal under review contemplates, inter alia, a devaluation of the present U.S. dollar holdings of foreign official holders; these would be paid off in gold at their new (i.e. reduced) value following the proposed revaluation of gold. Thus, in effect, some of the present external assets of surplus countries would be turned over to the United States, as a means of enhancing U.S.

confidence in its capacity to continue to provide large-scale aid (financial aid, that is) to developing countries. The surplus countries would be unlikely to regard such a transfer of assets as painless to them. Beyond this, there would be the worldwide inflationary effects of the easing of balance-of-payments discipline which might develop as a result of the nominal increase in the external reserves of many countries.

To some extent the foregoing comments have also covered Mr. Shannon's second main argument: that increasing the price of gold would be the best way to increase the supply of international reserve assets. While his argument simply ignores most of the well-known objections to an increase in the price of monetary gold, it represents a curious inversion of at least one of them. One of these objections is that raising the price of gold would add mainly to the reserves of countries--including the United States--not normally regarded as among the neediest cases. But one of Mr. Shannon's main defenses of his proposal is precisely that it would add substantially to U.S. reserves, and thus (he thinks) make possible substantially enlarged U.S. aid to developing countries for many years to come. For present purposes, it may suffice merely to note that most students of the international liquidity problem seem to have concluded that reserve creation through the establishment of a new international reserve unit would be preferable to an attempt to solve the reserve-asset problem through an increase in the price of gold--although Mr. Shannon is quite right that the distribution of reserve units would pose difficult problems.