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THE INTERNATIONAL MONETARY SYSTEM: ISSUES IN THE SYMPOSIUM

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The International Monetary System, after being buffetted for a number of years by successive crises culminating in the (temporary?) collapse of dollar convertibility in August 1971 and the Smithsonian Agreement on the realignment of parities, is now in a state of suspended animation. The monetary emasculation of gold with the two-tier system, the inconvertibility and devaluation of the dollar, the widened bands, the SDR's, the distinct if slow shift towards the link proposal, the hesitant but conspicuous attempt at European monetary unification and the "snake in the tunnel" regime; all these and other dramatic changes on the international scene underline the essentially transitory nature of the current international mechanism.

The contours of the "ideal", and the "ideal *and* feasible", world monetary order are actively under debate, not merely among the central bankers but among the international monetary experts, many of whom are brought together in articulate company in this Symposium. This is indeed in tradition: academic economists played an influential role in the design of the international mechanism at Bretton Woods; and they have actively interacted with policy-makers over the years in analysing and interpreting the changing and mercurial events that have held the stage in the last decade.

By the early 1960's, the experience with the pegged-exchange rate Bretton Woods international mechanism, and the growth of world trade, had given rise to focus on the following five major "problems":

(1) *The liquidity problem*: Triffin, in a number of classic contributions, had drawn attention to the question of inadequate growth of world reserves. The falling real price of gold, as the world price of

[1] Cf. his Gold and the Dollar Crisis, Yale University Press, 1960.

commodities rose while the price of gold was frozen, led to inadequate growth of gold production and hence of growth of international gold reserves. At the same time, the growth of reserves *via* the accrual of fresh dollar liabilities was imperilled under the "dollar standard" because of the growing imbalance between U.S. gold holdings and the rising U.S. liabilities: the dollar standard had the inherent contradiction that the expansion of reserve dollars would require continuation of U.S. "deficits" which would erode confidence in the dollar sooner or later.[2] The world thus had to be steered towards the creation of a new, and reliable, international reserve asset whose supply would be regulated "rationally". Hence Triffin's notion of an XIMF providing this function, the Stamp Plan, the different variations on Keynes' Bancor plan, and the ultimate and realised creation of the SDR's at the IMF.

(2) *The crisis problem*: The dollar standard not merely created the "inherent" problem that the dollar liabilities could not be endlessly continued and hence the expansion of liquidity to finance world trade would be jeopardised. It also created the "crisis" problem: the speculative flight from the dollar (and from the pound, which had a sub-stellar zone of "influence" as a key currency, residual from its earlier dominant role in an earlier age), to stronger currencies such as the mark and the guilder as fears of sterling or dollar devaluation or of mark revaluation mounted from time to time: the accumulated dollar and sterling holdings were sufficiently large to make this possibility a real and recurring disturbance and give the "gnomes of Zurich" a permanent place in the vocabulary of the common man. While the shortrun solution seemed to consist in the "swap" arrangements and an evolving central banking code to hold onto speculative inflow of dollars (sterling) rather than to seek confrontation through demand for conversion into gold, the longrun solution seemed to consist in reduced reliance on the key currency system and more flexibility *via* widened bands, for example, to make speculation less rewarding.

(3) *The reluctant exchange rate adjustment problem*: The 1950's also witnessed the development of a situation where both the rich and

[2] This point was formalised by Kenen in a well-known paper, International liquidity and the balance of payments of a reserve currency country, Quarterly Journal of Economics, 74 (1960), 572–86; and has been analysed further by L. Officer and T. Willett, Reserve asset preferences and the confidence problem in the crisis zone, Quarterly Journal of Economics, 83 (1969), 688–95; and by J.H. Makin, On the success of the reserve currency system in the crisis zone, Journal of International Economics, 2 (February 1972), 77–85.

the poor members of the IMF were to exhibit a distinct reluctance to change their exchange rates – making a mockery of the fears of the architects of the IMF that the postwar situation would be one of "competitive depreciation". This, in turn, meant that countries had lost one policy instrument which, with domestic monetary and fiscal policy, could have helped reach the two targets of internal and external balance.[3] The resulting payments difficulties in countries which would not or could not deflate (and who were bound at the GATT from using tariffs extensively) were to plague the IMF during the 1950's and later.[4] The solution seemed to point in the direction of exchange rate flexibility: the range of proposals extending from widened bands to gliding parities and crawling pegs.[5]

(4) *The equity problem*: The key currency status of the dollar, in particular, was also to attract attention, not so much to the *difficulties* arising for the United States (something that emerged clearly only as the dollar overvaluation became more acute and manifest in the latter part of the 1960's), but rather to the alleged benefits therefrom. In particular, the Gaullist concern was focussed on the fact that the United States could virtually finance any deficits by increasing its dollar liabilities, unconstrained by its reserves in quite the same way as other countries. This "seigniorage" aspect of the reserve currency defined in the early years the "equity" question: should the international monetary system allow one country, no matter why, to enjoy these alleged

[3] Mundell's major contribution was to resolve this dilemma analytically by bringing capital flows back into the discussion and linking them essentially to interest rate policy – thus opening up a new instrument to affect the balance of payments. Much of the later Mundellian policy discussion, however, suffers from inadequate recognition that (1) *both* fiscal and monetary policy can directly influence the balance of payments: e.g. changes in the corporation tax can influence long-run flows of capital: tax concessions to foreign investment can and do influence its flow; (2) the analytical structure of the instruments-objectives problem can be simplified if differential interest and tax rates on foreign and domestic decision-makers in the relevant markets are permitted, as indeed they should be; and (3) any achievement of internal and external balance by resort to the capital account must necessarily be linked up eventually with the long-run effects on the economies of the international system, calling for the integration of the discussion into a dynamic, time-path mode of analysis.

[4] This is not to say that exchange rate changes were infrequent in the postwar period; rather, that they were inadequate. For evidence on the frequency of parity changes, see the excellent article by Margaret de Vries, Exchange depreciation in developing countries, IMF Staff Papers, Vol. 15, November 1968.

[5] On gliding parities, in particular, see E. Howle and Carlos Moore, Richard Cooper's gliding parities: a proposed modification, Journal of International Economics, 1 (4) (November 1971); and Richard Cooper, Comment on the Howle–Moore analysis and proposed modification of Cooper's gliding parity system, Journal of International Economics 1 (4) (November 1971).

benefits? The solution again seemed to be along the lines of Triffin's original proposals to consolidate and liquidate over time the reserve currency holdings, substituting for them an internationally agreed, new reserve asset with which *all* currencies would have an "equal" and symmetric relationship.

(5) *The aid problem*: As these problems became prominent in the professional discussion of the international monetary system, and the creation of a new international reserve asset became a respectable possibility, it also became clear that the Western developmental aid effort was beginning to falter.[6] It seemed natural, as the aid programmes seemed to be increasingly bogged down in countries such as the United States in annual wrangles in the legislative channels, to think of a non-budgetary method of supplementing aid flows. Hence arose the "link" idea, of trying to ally intrinsically the continual creation of international liquidity to simultaneous distribution of aid to the poor countries. The Stamp Plan was fully explicit on this score: the "gold certificates" would be initially distributed to the poor countries, who would spend them qua aid and which would then wind up as reserves in the rich countries. The proposal of the link in the SDR setup was to be the inevitable culmination of this notion.

All these "problems" thus tended to lead the thinking on the international monetary system, by the mid-'60's, in the direction of a modified IMF regime which would: (i) have greater exchange rate flexibility in one form or another, (ii) promote the creation of a new reserve asset by agreed international action, thereby reducing the reliance on the reserve currency system, (iii) lead to adequate expansion of liquidity to finance increasing world trade by suitable and systematic expansion of the new asset, (iv) encourage reliance on swap-type arrangements to handle residual speculative flows of funds, after the reserve currency holdings had been consolidated and substituted for the new international asset, and (v) have some form of link between the creation of the new asset and the supplementing of developmental aid flows.

By the mid-'60's, however, the international monetary scene had been transformed, and the perceptions of the problems with the existing regime changed, by the evident and growing overvaluation of the U.S. dollar. Whether it was (as Harry Johnson argues in his paper in thi

[6] The trends in aid levels and in the distribution of its burden and benefits, have been fully documented and analysed in my monograph, Amount and Sharing of Aid, Overseas Development Council, Washington, D.C., (1970), p. 197.

Symposium) the inflation in the U.S. caused by the Vietnam war, or the growth to economic maturity by Western Europe and by Germany in particular with its consequent Robertson-Hicks type pressure on U.S. comparative advantage or the spectacular growth rate of Japan which could be supported only by matching growth of imported materials and hence by the matching expansion of exports of sophisticated manufactures to the U.S. (which was a much more "open" market than Europe), it became clear that, in an essential sense, the dollar had shifted dramatically from a "scarce" to a "surplus" status. This overvaluation of the dollar, combined with the "crisis" problem, was to create the central dilemma on the international monetary scene in recent years: how was the dollar parity to be adjusted to this changed situation?

This *adjustment problem*, which clearly existed as a reality in the minds and policy thinking of the principal actors on the international stage, thus could not be wished away despite the early Kindleberger (–Salant–Despres) view that the dollar holdings were largely "voluntary". Nor did it make any long-term sense to argue, à la Haberler–Willett, that the U.S. could forget about the adjustment and indulge in a policy of "benign neglect": because the Europeans, for sure, were unwilling to accept a situation where a continuing deficit in the U.S., financed by creation of more dollar liabilities rather than by use of other reserve assets, implied *either* that Europe should "import U.S. inflation" and accumulate "involuntary" dollar reserves *or* that the major European currencies be revalued in relation to the dollar.[7] Thus a policy of benign neglect would have meant, in reality and if sustained sufficiently long, a policy of "malign neglect"; and it could have triggered off the use of other retaliatory instruments such as trade wars, for example.

The continued failure to adjust the dollar parity thus meant that, in effect, the Europeans were unhappy. It also meant that the U.S. was unhappy: for the continually recurring speculative pressures on the dollar, the need to exhort the European central banks not to seek conversion, and the consequent exposure to the kind of flak (in the

[7] The option of revaluing the mark, say, as against the devaluation of the dollar was *not* a non-issue and the Europeans had a good point in their favour here. The former course, as against the latter, would have implied a net deterioration in the real worth of their total reserve assets (gold + SDR's + dollars). For a more detailed examination of the relative merits of these two options, see Franco Modigliani and H. Askari, The Report of the International Payments System, International Finance Section, Princeton University, 1971, pp. 8–11.

shape of pressure to deflate) that lesser countries in payments difficulties have to accept from the IMF and creditor countries, were taking their psychological toll on a country whose psyche was already deeply troubled by the sense of impotence despite overwhelming economic and military power.[8]

By the end of the 1960's, the mutual acceptance of the need to adjust the dollar parity had become manifest; and note that this acceptance was necessary principally because the U.S. is a force majeure in trade and investment and one cannot assume that, in the absence of such acceptance, a dollar devaluation would not be neutralised by matching devaluations elsewhere.[9] But the major remaining discord was on the optimal mix of devaluation of the dollar and revaluation of the other currencies, chiefly the mark and the yen.

This was the issue that was to begin being forcefully solved by the United States by the suspension of dollar convertibility and the dollar devaluation on August 15, 1971, and the deployment of the import surcharge: all adding up to a tactical policy of aggressive, malign neglect. The Smithsonian Agreement has now realigned the parities; the dollar incovertibility has continued; and the bands have been widened. Where do we go from here?

Two contributers to this Symposium, Robert Triffin and Marcus Fleming, meet this question head on. Interestingly, neither favours fully flexible rates – either on desirability or on feasibility grounds. And both conceive of an essentially "symmetric" solution which reduces the dollar eventually to the virtual level of other non-reserve currencies and assigns a pivotal role to SDR's. And notably, both authors consider several practical details of their overall conception – making their papers of great value to the policy-maker. Particularly rewarding is also Richard Cooper's contribution which provides a most useful and important complement to Fleming and Triffin in explaining in greater

[8] Paradoxically, Europe and the United States, each appears to have come to believe that the other was the beneficiary of the situation and itself the victim and even that, in this gentlemen's club of central bankers, the other was playing at times by Mafia rules! A good flavour of this Rashomon situation can be obtained from Harry Johnson's contribution to this Symposium.

[9] Indeed, for a long time, it was fashionable to argue that one of the major disadvantages of the United States was its *inability* (and not its *unwillingness*) to devalue successfully because of its reserve currency role. In point of fact, it is its economic size, rather than the reserve currency role, which seems to cause this particular problem, calling for a mutually *agreed* parity change by the United States: this being yet another "asymmetry" that an "equal" system must allow for.

depth, and with considerable insight, the problems inherent in the transition to a symmetrical system when, in fact, the current regime is *not* symmetrical: in short, how can the U.S. dollar be effectively "suppressed" into an "equal" role with other currencies: an issue on which Charles Kindleberger seems to bet that it cannot really be done.

In his interesting and trenchant review of the political economy of international monetary reform, Harry Johnson seems to take issue with those who favour the symmetry solution, castigating it as largely the outcome of a politically-motivated, U.S.-resenting European stance and a United States too "fatigued" to wish to continue shouldering the "responsibility" of a reserve-currency role. But if he does not favour the symmetry solution how does he really conceive a feasible, alternative regime? His i[illegible]on of Simons in a monetarist version and the necessity of the United States pursuing a non-inflationary domestic policy, linked perhaps to the return to dollar convertibility, would presumably make the current regime more viable: but, as Paul Samuelson remarks, this is indeed a counsel of despair: can the U.S. really avoid inflation; and, in any case, will not the *adjustment problem* resurrect itself if the U.S. continues to shift uneasily in its comparative advantage in response to an expanding Japan?

The Symposium has much for everyone. But it does have some "omissions". Only three are of any importance.

(1) The liquidity problem, or what might now be called the "optimum supply of international reserves problem", critical in determining the continuing expansion of SDR's in, say, the Triffin or Fleming "solution", has not been touched upon. [10]

(2) Nor has the Symposium (except for Triffin's brief approval) really considered the Aid Problem: tje question of the SDR link proposal. This is a proposal that, while being steadily pushed towards acceptance, still arouses deep resentments among certain international economists. To quote Harry Johnson in another context:

> It is in fact very unfortunate, in my judgment, that the less developed countries have chosen, and particularly that UNCTAD has chosen, to put so much weight on the link proposal as the way ahead in development assistance, and to support that proposal with obsolete arguments derived from the 1930s... But I can understand that countries that are thirty years behind the advanced countries technologically find it most comfortable to be thirty years behind them

[10] See, however, the excellent analysis of this problem elsewhere by Marcus Fleming, Toward Assessing the Need for International Reserves, International Finance Section, Princeton University, February 1967.

intellectually as well, and to select their approved advisers and spokesmen accordingly – though one might have expected the concept of 'leapfrogging' to be as applicable to intellectual as to industrial development.[11]

Strong words often mask weak arguments. In this instance, this is not so: as with numerous other LDC proposals at UNCTAD, the arguments produced to support increasing resource transfers are indeed not ones that would get past a Chicago or MIT examination committee. But a bad advocate should not be allowed to ruin a good case. And, in the ultimate analysis, the argument for the link is not one based on "seigniorage" nor one based on the assumption that it will rescue capitalism from its "chronic risk of mass depression and unemployment", but rather one of a second-best nature: i.e. to use one more prop on the international economic stage to channel more resources to the poor countries. One has to be naive, or politically motivated, to insist that only first-best rules be applied to solving the aid and li uidity problems while the world reality and one's own prescriptions on other issues – e.g. the acceptance of preferential entry for LDC-exports, despite its dominance welfarewise by free trade altogether – indicate rather strongly that second, third and *n*th best solutions alone are feasible and hence should be favoured.

(3) Finally, as with the link proposal, the whole problem of the "interest of the LDC's" in international monetary reform is missing from the Symposium. One thought, howeve seems too important not to set out here. The reluctant exchange adjustment mechanism, and the widespread LDC-reliance on e ge control as a method of regulating external payments, has led to economic and efficiency costs which have become increasingly evident in recent empirical studies.[12] *Any* reform of the Bretton Woods system which *builds* into itself, *via* widened bands – which nearly everyone approves of – or gliding parities – which Cooper and Samuelson like but Fleming and Kindleberger do not – would be of enormous value in getting several LDC's off their fixed-rate fixation and prompting them to use their exchange rate re-

[11] The Effect of the monetary problem on development cooperation: linking special drawing rights and development, Foreign Policy, Washington, D.C., 1972, forthcoming; presented earlier at the Hague Symposium on UNCTAD–III, Netherlands, 1972.

[12] See the forthcoming volumes on Exchange Control, Liberalization and Development, under an NBER Project, containing ten country studies on Brazil, Chile, Colombia, Egypt Ghana, India, Israel, Philippines, South Korea, and Turkey, and an overall, comparative volume by Bhagwati and Krueger.

gimes more freely and efficiently to balance their international accounts. Their objections to more flexibility need therefore to be resolutely ignored – in their own interest! [13]

More could have been said on these issues as well. But the Symposium was not intended to be "comprehensive". Rather, its objective was to bring together a substantial amount of major, fundamental thinking by noted, academic international economists on the reform of the international monetary system as the IMF began its, what might well be historic, deliberations on these critical problems at the September 1972 meetings. And, in this objective, the Symposium seems to have succeeded admirably.

[13] A similar "tactical" point has been made by Richard Cooper in the context of non-reciprocity demands by LDC's regarding tariff cuts: he has argued that it would be good for LDC's to reduce their excessive tariffs and that this would be facilitated if their governments could argue for tariff cuts by claiming that reciprocity requires this. Cf. his Third world tariff tangle, Foreign Policy, No. 4 (Fall 1971).