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INTERNATIONAL MONETARY RULES

Introduction

Outside the regulations imposed upon borrowers from an international stabilization Fund and the prohibitions (without the Fund's permission) of commodity exchange control, discriminatory rates, bilateral clearing, and of devaluations outside a stipulated margin, it is essential that certain other rules of economic conduct be imposed upon the members of a cooperative union if international equilibrium is to be maintained. The present pages attempt to arrive at desirable rules without much regard to their political practicability and with a recognition of the fact that they would require some changes in the apparatus contemplated in the Keynes and White currency plans. An "ideal" set of rules would seem to be the logical first step, since the ideals or final purposes of international currency arrangements completely condition the merit of all practical compromises.

The most idealistic form of such rules would probably be a categoric obligation assumed or imposed upon each member country to "do the necessary" (in the language of the army) in order to eliminate a lack of balance in its international position, while assuming also a general responsibility to serve reasonably full employment at home. Such a general rule might be supplemented by a list of practices frowned upon or prohibited by the commonwealth of cooperating nations. To the writer of these pages, this procedure - while certainly superior to an absence of rule - seems inferior to the formulation of a more extended list of positive rules, each designed to cope with particular situations. The general rule is subject to three objections: first, that "lack of balance" or "disequilibrium" is imprecise and fallible as a criterion of policy; secondly, a set of positive rules suited to particular situations seems to be more illuminating as to what to do than a general rule complemented by a list of things not to do; thirdly, the general rule implicitly permits latitude to a particular member country, but one of the primary merits of rules is that they form a basis of certain knowledge to other players as to what will be done. In international economic relations the area of uncertainty is inevitably large anyway, and the merit of rules is to make economic calculation less hazardous. Wherever it is possible, therefore, to designate one particular method of correcting unbalance as superior to others, the rules ought (ideally, of course) to do so.

A short explanation is in order as to the vagueness of an injunction to adopt policies to correct a "lack of international equilibrium." As Pigou explained, equilibrium in the international field can be thought of at three (or possibly more) levels. At the most superficial level, there is equilibrium in the sense of an exchange rate which "clears the market" i.e. leaves no sellers who would sell at the present rate or below, and no buyers who would buy at the present rate or above. Under the gold standard any rate satisfies this condition, for even at the gold points, as long as

gold continues to be available, all traders are satisfied. Under a paper standard, however, the rule to secure "equilibrium" could be taken as an injunction to revise the rate of exchange upward or downward to set the demand for and supply of exchange in equilibrium. Or it might mean to achieve an "equilibrium" of sorts, without fundamental economic adjustment and without changing the exchange rate, either by rationing the demand for foreign exchange or by accumulating foreign balances. Or finally it might mean to recommend fundamental production or consumption changes which would permit the retention of the old exchange rate without intervention on the foreign exchange markets.

A rule of this variety has the merit, of course, of leaving a maximum latitude to the discretion of the member country. But it may be doubtful whether the rule is worth stating, since if a country on a paper standard encounters a threatening or actual disequilibrium of the sort now under discussion - a shortage or oversupply of foreign exchange - it can in all events be counted upon to cope with the "disequilibrium", and not leave it to the unregulated action of the exchange market. Rule or prescription takes on significance only as it secures the adoption of the best or superior devices for bringing about equilibrium. If the choice of the individual country is accepted in all events, then rules are superfluous.

When we proceed to other meanings of balance or equilibrium than the "clearing the market" meaning, the situation appears even less favorable to a general injunction, inasmuch as various equilibria may appear which are not synonymous and indeed which are sometimes mutually inconsistent. For example, at a level more basic than the "clearing the market" equilibrium, is the ordinary concept of a balance of payments in equilibrium. This implies an absence of most gold movements and all "speculative" capital movements for a gold standard, and an absence of all "speculative" capital movements for a paper standard. Capital movements answering to genuine differences of productivity are not incompatible with this equilibrium nor is the movement of gold from gold producting to gold using countries.

A third sense of international equilibrium pertains to the factors and implies an equal rate of return as between various economies. In view of the "unequal" districution of factors, it is clear that the rule to work toward equilibrium in this sense would produce at least a transitional disequilibrium in the trade balance and balance of payments, and the attainment of equilibrium for one factor might be attended with remaining disequilibria on others.

The fact that there are various equilibria would not interfere with the formulation of a general rule, inasmuch as one specific type of equilibrium could be singled out and the rule together with exceptions could be formulated appropriately to the particular equilibrium. Since the orientation of the present schemes is rather toward an international monetary system than toward an investment authority or still less an inclusive international economic authority, the equilibrium singled out would presumably be that of the balance of payments. Even so, the point remains: disequilibrium in the balance of payments can be produced variously and the cure has to be fitted to the cause. Thus a rule coping with a purely "psychological"

flight of capital would presumably not be appropriate to a movement of capital induced by genuine productivity differentials; or a rule coping with inflation arising from a simple incapacity to raise revenue might differ from a rule appropriate to inflation appearing incidentally to a deliberate budget deficit to induce economic expansion.

The procedure of the following paragraphs is to set down the major causes of international monetary disturbances, and then to consider appropriate cures in each case. In the present context, a "international monetary disturbance" is conceived to include exchange instability and unemployment induced from abroad.

Sources of International Monetary Disturbance

I. Real causes: changes in productivity, or productivity differentials.
   A. Supply side: technology, natural resources, labor and entrepreneurial motivation, etc.
   B. Demand side: foreign markets, transportation, foreign competition, etc.

II. Domestic monetary changes.
   A. Inflation or deflation induced by the "public."
   B. Inflation or deflation induced by the "government."

III. Capital movements of "peculiar" character.
   A. Short term, induced by fear of currency depreciation, or unsound banking institutions; or by booming stock markets or by central banks money market policies.
   B. Long term, induced by differences in national tax policies, by political persecution, etc.

IV. Institutional influences on trade.
   A. Trade union influences on wages.
   B. Domestic monopolies and dumping.
   C. Collective economies and absence of ordinary cost criteria.
   D. Tariffs.
   E. National price ceiling and rationing.

It is, of course, recognized that these categories are not always mutually exclusive. But the mere fact that a variety of "situations" actually occur is sufficient evidence that one or other cause is recognized as preponderting and is therefore the chief (though not exclusive) concern of policy makers. Action appropriate to one cause may occasionally be appropriate also to attending causes, though occasionally also the situation will inevitably be "awkward" in the sense that even the best policy will have unwelcome repercusions.

Rules to Correct Disequilibria

I. Real Causes

Occasionally it may be that long term loans will remove a handicap proceeding from these forces, but this is not always the case. Consequently it is almost impossible to imagine the substitution a

general rule for discretionary power on the part of the Fund.

The nearest approach to an adequate general rule would be obligatory appreciation or depreciation of the exchange rate. Since the forces envisaged under "real causes" are in general slow moving, the resort to exchange rate adjustment would not be too frequent to be incompatible with the relative stability envisaged by the present plans.

II. Domestic monetary Changes

A. Inflation or deflation induced by the public.

In an "ideal" system, a rule would probably provide that inflation or deflation exceeding certain limits in a given interval would be taken as evidence of incapacity of the government to deal with the situation, and would automatically bring into play certain stipulated domestic measures instituted and managed by the Fund.

Since this is politically unlikely, the best substitute would be the obligatory adjustment of exchange rates to keep pace with changes in internal purchasing power.

B. Inflation or deflation induced by the government.

In order to deter governments from full employment policies involving too much inflation or from deflationary policies, certain stipulated measures (differing in character from those under II A) might be automatically obligatory upon the governments, if the inflation or deflation passed certain limits.

Again, lacking such a rule, obligatory rate adjustments would be indicated.

III. Capital Movements of "Peculiar" Character.

It would appear to be next to impossible to deal with these by rule, since only the particular circumstances determine whether the movement is "peculiar", and if so whether it should be prevented. This signifies that discretionary power is necessary to the Fund. In general the presumption would be in favor of direct controls, rather than rate changes.

IV. Institutional Influences on Trade.

A. Trade union influences upon costs.

Compensatory rate of exchange adjustments would be the only method of coping with a force which governments themselves cannot control.

B. Domestic monopolies and dumping.

A simple rule, which it would appear possible to enforce, would prohibit sales at different prices at home and abroad.

C. Collective economies.

No rule can guarantee against dumping in these circumstances. But some regulation of the frequency of price changes might deter a collective economy from selling below prices on world markets.

D. Tariffs.

A rule against employing tariffs as a device to secure foreign exchange equilibrium might have some value, though this is doubtful.

E. Price ceilings.

It might be provided that governments are obliged to suspend official prices on goods entering into international trade, unless these goods are subject to international regulation.

The application of the method indicated in the foregoing paragraphs has significance only if the international monetary agency has some power over domestic monetary and fiscal policy, and over national commercial policies. If it does not there is no point in distinguishing the causes of disequilibrium. The only thing then possible is some sort of generic rule or injunction such as the maintenance of equilibrium in the balance of payments and reasonably full employment. The following might be one form of such a rule:

In the event a national currency becomes scarce, the Fund shall be charged with responsibility for determining the causes of this scarcity. If the causes lie chiefly in the international position of the country whose currency is scarce, the Fund shall offer to it the following options: (1) Extending loans to the Fund in national currency; (2) Appreciation of its exchange rate to level necessary to produce equilibrium in the balance of payments; (3) Adopting measures not otherwise prohibited for correcting the scarcity. If the causes lie chiefly in the international position of one country demanding the scarce currency, the Fund shall offer to it the following options:

1. Devaluation of its exchange to a level necessary to produce equilibrium on the exchange market;
2. Adopting measures not otherwise prohibited for reducing its demand for the scarce currency.

If the causes seem to inhere in the situation generally, the Fund may pursue both policies concurrently.