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To: Members of the Executive Board

From: The Secretary

Subject: Conference on International Money, Credit, and the SDR

The Conference on International Money, Credit, and the SDR was held at the Fund on March 24-25, 1983. All the presenters, discussants, and other persons identified in the program attached to EBAP/83/44 (2/15/83) participated as scheduled. As previously indicated, it is intended that the conference proceedings be published and that a general summary of the discussion in the final session (organized by subject matter) be included.

The attached summary, prepared in the Research Department by Mr. George von Furstenberg, would constitute Chapter IX of the conference volume; no attribution to individual participants or Executive Directors is made. The eight conference papers and the prepared comments pertaining thereto would constitute the earlier chapters; the background papers listed in EBAP/82/202, Supplement 1 as corrected (9/24/82), would be Chapters X-XIII.

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International Money, Credit, and the SDR

IX. SUMMARY OF FINDINGS

A panel discussion between Executive Directors and the presenters of the eight papers contained in the previous chapters concluded the Conference on International Money, Credit, and the SDR. Utilizing many of the thoughts expressed by the panelists, this chapter attempts to characterize the main findings of the conference and some of the remaining differences in views. The topics covered in the wrap-up session ranged from evaluations of general aspects of the current international monetary system to consideration of the SDR, surveillance, and the role of the Fund. This chapter is organized according to these topics and avoids attributing views to individuals in summarizing positions taken on the subject matters discussed.

How the System Has Functioned and How It Can Be Improved

The chief aspects of the prevailing international monetary system that were appraised related to the appropriateness of exchange rates and exchange arrangements, the harmonization of monetary policies, and the degree to which the system has facilitated international trade and the efficient transfer of resources between countries. Suggested improvements centered on ways of enhancing stability through increased policy coordination, with the possible assistance of Fund surveillance and of explicit exchange rate commitments. More pervasive changes of the kind that could conceivably produce an entirely new international monetary system received little attention. Some panelists welcomed this forbearance because they felt that monetary systems--like constitutions--should not casually be experimented with; major changes should be made infrequently and then only if there were good reason to expect substantial improvement. Others regretted the lack of consideration of the most far-reaching proposals for reform that would redress defects and asymmetries of the present system, particularly with regard to the developing world.

Fundamental disequilibria of the type that called for negotiated adjustments in exchange rates under the Bretton Woods system have not disappeared under floating rates. Although such disequilibria are now much more difficult to identify or to anticipate than formerly, a number of panelists cited recent episodes in which certain floating exchange rates had moved well beyond the range that might be regarded as compatible with efficiency in international trade and finance. There was widespread agreement that the exchange market is not always right and that, over time, private capital markets are not always efficient or stabilizing. However, opinions differed on whether better performance could be ensured by making major changes in the way the authorities operate under the present system.

It is difficult for many countries to have domestic stability without approximate stability of real exchange rates. Conversely, exchange rate stability is impossible to maintain over any extended period of time unless there is domestic stability. For these reasons, there has long been debate on which kind of stability should come first. Panelists put aside the question of whether domestic stability or exchange rate stability should be the starting point for achieving overall stability by arguing that countries should simultaneously pursue both.

Exchange rate intervention need not be ineffective or lacking in credibility if it is supported by an explicit commitment to an exchange rate target range that is consistent with macroeconomic policies, particularly money supply policies. Whether or not any such intervention should be sterilized depends very much on what exchange rate pressures or movements are believed to reveal about expected inflation differentials with other countries, transitory versus permanent changes in money demand, or structural changes in international competitiveness or in relative prices of a country's main exports and imports. At the very least, it was agreed, there is nothing to be gained by ignoring the information about desirable changes in domestic policies that exchange rate pressures can convey. For instance, rising nominal interest rates, if coupled with a tendency for the external value of a currency to depreciate, can signal a rapid rise in the expected inflation rate, falling real rates of interest, and the need to reduce the rate of money growth. If the United States and other countries had heeded such signals in the 1970s, price stability would not have deteriorated to such an extent as to require the painful and costly corrections made in the early 1980s, which have damaged trade, production, employment, and the international transfer of resources.

Since exchange rates are multilateral, the signals they convey should normally have implications not only for a single country but for all countries whose policies are important to the functioning of the international system of trade and finance. One of the factors affecting exchange rates is speculation about future monetary and macroeconomic policy in each of the countries involved. Hence, there is room for coordination; concerted intervention strategies and the harmonization of policies in the pursuit of common goals are clearly desirable in principle.

In reality, the macroeconomic decision-making processes within several major countries are compartmentalized; forecasts and the interpretation of signals are uncertain and contested; and perceptions about desirable trade-offs between objectives and about relations between policy instruments and goals keep changing. Given that internal coordination is incomplete, tentative, and easily upset by new political and economic developments, several panelists found it difficult to see how policy harmonization between major countries could be promoted effectively through formal agreements between them. Though harmonization of macroeconomic policies can technically be achieved more easily the smaller the number of countries included in the negotiations, the political costs can be higher the greater the number of countries that are excluded. For these reasons, many panelists felt that surveillance by the International Monetary Fund might have a special role to play in harmonizing policies.

By contrast, panelists generally felt that there was little chance that policies could be harmonized by means of tight agreements among major countries' monetary authorities or through a return to fixed exchange rates. Although it is incontrovertible that inflation has been higher and the growth of trade and production lower in the floating-rate period of the seventies than in the fixed-rate period of the sixties, association does not prove causation. Many factors other than the floating system per se affected exchange rates, macroeconomic stability, and growth prospects in the seventies, most notably the two oil price shocks. Because of these episodes and differences in the lags with which industry structures and real wages tended to adjust, interest and inflation differentials arose which detracted from stability in a way that cannot be attributed simply to floating. In some situations, the adoption of floating may have facilitated the pursuit of undesirable policies; in other cases, it may have improved economic decision making and the economy's ability to cope with external shocks. Thus, most panelists appeared to feel that summary evaluations that abstracted from the particulars surrounding the choice of exchange rate regime--if, indeed, there is such a choice--were not very useful.

Nevertheless, there was also a feeling that in the present world of partial floating and emerging protective currency unions, it would be wishful thinking to assume that exchange rate volatility could be regarded as harmless and thus benignly neglected. Even if, in the past turbulent decade, the resulting ill effects of volatility did not seem particularly conspicuous, or if volatile exchange rates were somehow tolerated within the imperfect framework of the international system, it was felt that complacency about volatility would certainly be ill-advised.

At the present time the international monetary system faces several pressing problems. The international debt crisis is probably the most urgent among them. Success in overcoming that crisis requires that there be (1) a robust and sustained recovery in all major industrial countries; (2) prolonged and painful adherence to austere policies in debtor countries; (3) a retreat from present protectionism; and (4) continued commercial bank lending and, for a sustained period, an increase of bank exposure.

In the short run, these requirements can only be met through increased cooperation between private, national, and international financial institutions. Beyond that, however, the need to meet these requirements may also spawn new information and management systems and arrangements for funding and the international transfer of resources that directly involve increased reliance on Fund conditionality, surveillance, and resources. The sense of several panelists' remarks thus appeared to be that innovations in the present international financial system derive primarily from what is learned in particular crises and that relatively little effort is made to anticipate or forestall possible future crises of different origin. Nevertheless, these improvised innovations may serve as building blocks in the construction of a reformed international financial system.

SDRs, Surveillance, and the Role of the Fund

Panelists expressed a fair amount of skepticism about how far one could push in the direction of making the SDR the principal reserve asset in the international monetary system. Even after it was explained that an asset need not be quantitatively the most important to be regarded as having a principal role to play, doubts remamined about what the SDR's role would be. Hence any practical steps taken with the SDR would have to be evaluated on their merits, rather than on how they enhanced the role of the SDR.

One of the practical steps that found almost unanimous support was to meet liquidity, funding, and reserve needs partly through SDR allocations. Whatever some might once have thought about the degree of excess liquidity *in the system and how it should reflect on the* desirability of SDR allocations, fears of any such excess and its inflationary potential would surely be groundless under current conditions. Rather, an SDR allocation would contribute to maintaining the international movement of funds and goods and reduce the drag on any worldwide recovery that would stem from attempts to rebuild depleted reserves by other, contractive means in the face of inelastic supplies of international credit. For these reasons, the idea of an SDR allocation, if conducted as in the past and not used as a substitute for bilateral aid, found very wide support among the panel.

Some panelists added the qualification that SDR allocations, no matter how important, should not take priority over increasing Fund resources for conditional lending, if there are only a limited number of things that can be accomplished at this time. Greater availability and use of SDRs in the conditionality programs of the Fund would, itself, deserve further study. Others emphasized that SDR allocations can never be viewed in isolation and that the Fund's conditionality and surveillance programs, if implemented evenhandedly, would ensure that the SDR, although containing elements of automaticity, would be used to support appropriate policy stances. Greater allocation and use of official SDRs under the overall supervision of the Fund would ensure availability and continuity of reserves and a more equitable distribution of Fund resources.

In addition to the SDR's use as official credit, panelists discussed its possible uses in intervention and in private capital markets as ways of getting industrial countries to take greater interest in the SDR. Major countries are not likely to want to use SDRs in intervention operations on a large scale unless they have first agreed on target zones for the external values of their currencies, some of which could be defined in SDRs. Even then, they could not do so unless there were fungibility between the Fund's SDR and SDR-denominated instruments in private markets. The institution of a clearinghouse was therefore discussed in which official holders could deposit SDRs in return for claims that could be transferred among themselves as well as between themselves and participants in the private market. Since the rate of return that the clearinghouse could offer on its SDR-denominated deposits would be determined by the terms prevailing on its SDR assets, whose value in use is continuously assured by official constitution and by the transfer services provided by the Fund, measures to increase the attractiveness of the Fund's SDR would also increase the demand for SDR deposits. Hence certain avenues of development came into view during the discussions along which the SDR could evolve from what some panelists characterized as a subsidiary credit instrument into a full-fledged monetary asset.

Surveillance by the Fund has already been mentioned on a number of occasions in this chapter as an important aid in ensuring the appropriateness of policies, exchange rates, and the use of external resources. A number of panelists remarked, however, that surveillance, no matter how conducive to the smooth and efficient functioning of the system, tends to be more powerful when applied to some groups of countries than to others. They had no doubt that the Fund has been capable of appraising and influencing the exchange rate policies of many of the countries that have drawn on its resources over the years. However, they asked, can the Fund effectively influence the exchange rate and money supply policies of major countries, particularly if their currencies are floating against other major currencies under conditions of high capital mobility?

While the quality of the Fund's surveillance and conditionality programs, and hence the credibility of the Fund, were judged to be high, opportunities for extending that surveillance to major countries not in external difficulties were regarded as rather limited at present. Surveillance exercises might readily show that there are persistent, harmful, and costly disequilibria in exchange rates; yet no effective pressure apparently could be brought to bear on major countries to implement the policies required to eliminate these disequilibria. Some panelists saw in this a basic injustice of the present system that ought to be reduced by strengthening the hand of the Fund and focusing international concern on the policies pursued by major industrial countries.

Several more stressed that logical application of surveillance is inherently global and that surveillance has to be done within a system setting. The proposition "you look after your exchange rate, and we will look after ours" just does not work for the world as a whole. Thus, one cannot approach surveillance and exchange rate inappropriateness on a country-by-country basis, except possibly for very small countries. On the other hand, it was also recognized that even though surveillance has broader systemic applications, which should be strengthened, stabilization programs and loans are what earns surveillance its keep. Panelists found such programs to be the most important component of the Fund's regular business and one that needs to be expanded on account of its benefits to the system.

Regarding the size of the Fund, panelists appeared to agree that they would not like to see the major activities of the Fund curbed significantly by resource limitations at this time. No dissent was expressed from the view that the Fund should actively pursue lender-of-last-resort and rescue efforts and should engage on a much larger scale in conditional lending.

Some panelists suggested that if quota increases and the General Arrangements to Borrow should prove unequal to these tasks, other arrangements, including Fund borrowing in private markets, might have to be reexamined.