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MONEY CRISIS - DANGERS AND OPPORTUNITIES

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The week before Christmas has been a productive one for the international monetary system. It has witnessed the most important realignment of exchange rates since the second world war. The Group of Ten hammered out an agreement by which the dollar was devalued vis-à-vis the pound and the French franc, which two currencies maintained their gold parity, and four other currencies were revalued upwards. After that, the 108 other members of the International Monetary Fund had to make up their mind and consult with the Fund on the question whether they also wanted to revalue their currency, stay with the pound and the franc, stay with the dollar, take an intermediate position, or take advantage of the fact that exchange rates were on the move to carry out an overdue devaluation going beyond the devaluation of the dollar. As a result of all this, the world starts the new year with a completely renovated set of exchange rates; quite an accomplishment.

Yet the agreement on a general realignment of exchange rates leaves most of the long-term structural problems of the international monetary system untouched. True, margins have been widened to $2\frac{1}{4}$ per cent, a figure more in harmony with present-day conditions than the previous margin of one per cent which had its origin in the cost of shipping gold under the nineteenth century gold standard and had lost touch with reality. But this is a relatively minor matter. True, the world has witnessed the first really multilateral determination of exchange rates among the main currencies. And the new rates are 'central rates' rather than par values, which presumably will make it easier to change them. But they have been determined by a series of highly publicised conferences of finance ministers and under the watchful eye of heads of state, a procedure which is the very opposite of the process of taking politics out of the determination of exchange rates, which is advocated by many.

Lastly, and perhaps most paradoxically, at a time when there is a general agreement on the necessity of diminishing the role of the dollar in the international monetary system, the dollar has moved even further to the centre of the system. For it is by buying and selling inconvertible dollars that the monetary authorities are, at least temporarily, going to maintain the exchange rates agreed upon. This movement against the trend of the times is bound to bring pressures for a further reform of the system.

A new role for SDRs

What must be the essentials of that reform? The difficulties have their origin in the absence of a reliable and secure international 'money' of a dependable intervention vehicle to be used for stabilizing and defending such new exchange rates or parities as may be agreed upon. For the dollar, having become inconvertible, can no longer fulfil this role. In the present evolutionary phase of the international monetary system we have to move to a neutral international intervention vehicle, not linked to any one nation.

In principle only gold and SDRs would qualify. A return to the use of gold as an intervention medium, as was the case under the 'true' gold standard of the few decades after 1870, should re rejected. Neither the supply of the metal--depending as it does on gold mining, not the demand for it--which is influenced to an increasing extent by industrial uses, can be controlled adequately, as a consequence of which its future price becomes uncertain, thus making it vulnerable to further disturbances as a result of speculation.

Therefore, SDRs should be made to function as an intervention vehicle. There is no need here to go deeply into the technical aspects, which, as always, are solvable if the political determination to reach a solution is present. If the central banks of the industrial countries would agree that henceforth they would buy and sell their own currency only against SDRs, the system would, thanks to exchange arbitrage, function in the same way as it did before August 15, when they bought and sold their own currency against dollars.1/ However, there would be one important difference. With the rate of the dollar no longer determined through dollar interventions on the part of other monetary authorities, the American authorities, too, would have to operate in the exchange market and would indeed be able to do so. They would thus have to finance possible deficits by selling SDRs on the exchange market. But in return for this the U.S. authorities would have gotten an operationally effective method for changing the par value of the dollar, namely by changing, like any other country, the rate at which they stand ready to buy and sell their currency against SDRs. In the system operative before August 15, under which the U.S. authorities dealt only in gold, they did not dispose of an operationally effective method to change the exchange rate of the dollar in terms of other currencies. They disposed only of an operational method for changing the price of gold, namely by setting new buying and selling prices for the metal. Even now, with only the dollar as an intervention vehicle, it is the intervention policies of other countries that determine the exchange rate of the dollar, and there is no direct way in which the U.S. authorities can influence that rate.2/ With the suspension of transactions in gold by the U.S. authorities,

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1/ Putting the matter in different terms, the gold points of the gold standard would be replaced by 'SDR points', i.e. rates at which a country's central bank buys or sells its own currency against SDRs.

2/ Aside from a direct currency war, in which, for example, the French authorities would buy dollars to stabilize the rate and the U.S. authorities would buy French francs in order to depreciate the dollar vis-à-vis the franc.

even the operational way of determining the relation of the dollar to gold has disappeared, and the international price of the dollar has become wholly dependent upon the policies of other monetary authorities.

The use of SDRs as an intervention vehicle is possible only if private financial institutions may hold them. If one wants to limit SDR holdings in private hands in order to prevent the SDR from influencing national currencies and national monetary policy too much, this can be facilitated by stipulating that interest on SDRs will accrue only to official holders. Thus one would create an incentive for private institutions to limit their SDR holdings to real working balances.

A reform along the lines sketched above would also reinforce the role of the SDR as a reserve asset. If the monetary authorities were to use SDRs rather than dollars as an intervention vehicle, this would be likely to give rise to a propensity to hold a larger portion of reserves in the form of SDRs. Reserve accumulation would initially accrue in the form of SDRs, and experience has shown that monetary authorities tend to be rather slow in converting their intervention vehicle into another reserve asset. It is probable that it would then also become necessary to work out an arrangement under which part of the sizable dollar balances at present in the hands of monetary authorities would be transferred to the IMF in exchange for a special issue of SDRs. Within the framework of such an arrangement, consideration should also be given to the question of whether, and to what extent, an additional credit would be required to enable the United States to finance, under the new régime, a payments deficit that might well continue for some time after the general realignment, as a result of the fact that an exchange rate adjustment has its full impact on trade flows only after a time lag of one or two years.

The system proposed would not exclude a measure of freedom with regard to the composition of reserves. Just as it was possible for the sterling area to exist under a régime of dollar intervention, it is conceivable that under a régime of SDR intervention there would also be a dollar area, composed of countries which, because of their close financial relationship with the United States or for similar reasons, would continue to show a strong preference for the dollar. The essential thing is that the major trading countries adopt the new régime. Participation by other countries will be most welcome indeed, as it would greatly simplify and strengthen the system. But if the strong preference for the dollar existing in certain countries and regions should create difficulties, it would be possible to accommodate that preference.

It has been said gold intervention is a system of the past, while SDR-intervention may only be the system of the future which cannot be realized in the short run. If indeed one does not want to use gold and could not use SDRs, the use of 'ultimate reserve assets' as an intervention vehicle would be out of reach and continued reliance on national currencies would be necessary. It would then become unavoidable to consider a shift from intervention with one national currency to intervention with a number of widely traded currencies. Such a system would require clear-cut rules about the regular settlement of accumulated balances. Under the provisions of the European payments union of the '50s monthly settlement of accrued balances took place. An 'international payments union' would have to function in a similar way. In this connection it is of interest that the provisions of the Articles of Agreement of the International Monetary Fund are rather close to such a settlement régime. They show in any case more resemblance to such a payments union than to the intervention techniques which slowly developed after the war under the predominance of the dollar.

Incentives for a U.S. initiative

Rather far-reaching reforms will in any case be necessary for a return to sustainable and orderly international monetary relations. The reforms regarding the exchange rate system and those in the field of intervention policy discussed above will have consequences for the creation of international liquidity and the granting of negotiated credits. The necessity of a consolidation arrangement for the balances in reserve currencies accumulated over the years, as a result of the shift to a neutral internationally created and managed intervention and reserve medium, was also indicated.

The realization of such reforms will require active leadership on the part of the U.S. authorities; I shall return to this question presently. But why should the United States take the initiative? The answer lies in the developments likely to occur in the absence of an American policy lead.

It has already been pointed out that if the other industrialized countries would only have the inconvertible dollar at their disposal as an intervention vehicle, the lack of a suitable international 'money' would entail the risk of a relapse into fluctuating rates, even after realignment. But it is likely that the European countries in particular would, after some time, come to regard the risk of recurrent fluctuations in their mutual exchange rates as intolerable and incompatible with their efforts to achieve further monetary integration. They would want to stabilize their mutual exchange rates, and create a usable intervention vehicle to be able to do so. In the absence of reliable international 'money', they would create regional 'money' in the form of some regional settlement system.

But the appearance of regional blocs with mutually fixed rates and regional 'money' or a regional settlement system would carry with it the risk of serious damage to monetary co-operation on a world-wide scale. When there are regional intervention vehicles and fluctuating exchange rates between the blocs, the need for an international means of payment such as the SDR is reduced. Thus, a promising development in international monetary co-operation becomes in danger of being interrupted, or slowed down significantly. Moreover, there is the serious risk of restrictions on trade and payments between the blocs. The restrictions on capital movements imposed by a number of countries in the past few months foreshadow such a development.

The manner in which such regional blocs would come into being is of decisive importance. If the EEC countries continue their efforts in the field of economic and monetary integration, and if as a result of the progress achieved a European personality would emerge in international economic relations, such an evolution would be most welcome indeed. But if this were to happen as a reaction to an inhospitable international climate, as a defensive move, then that European personality would show entirely different characteristics. For it is no secret that there is a running controversy on the question as to whether the new Europe will be outward-looking or inward-looking, whether it will be internationally minded or isolationist. The Dutch position in this regard has constantly reflected our age-old international traditions.

It is, moreover, not to be excluded that a European bloc that would have come into being as a reaction to a hostile international climate, would pursue anti-American policies. For example, it might, in absence of an improved SDR, decide to replace the dollar for regional settlements by gold rather than by a European settlement system. In other words, the European monetary authorities might decide to freely buy and sell gold for monetary purposes. But, since they would lack sufficient political power to prevent other monetary authorities from buying gold from them for re-sale on the free gold market, such a policy would only be practical at a price somewhat higher than the price on the free gold market, i.e. the equivalent of, say, $45 to $55 per ounce. The international transactions of the EEC countries together with Switzerland are of sufficient size to make such a price stick. In any case they would not be hampered by whatever nominal gold price the U.S. authorities would profess to adhere to, but at which transactions no longer take place. A defensive move against the present American monetary policy might then lead to a decisive step backwards in the evolutionary process--a step that would bear considerable resemblance to the developments in the dismal year 1933, when in a situation of great monetary confusion the United States decided upon a major increase in the price of gold.

The need for American leadership

Agreement on steps that will promote a constructive evolution of the international monetary system is possible only, at the present juncture, if the United States takes the initiative and assumes the leadership. The founding of the International Monetary Fund in 1944 took place under strong American sponsorship. The setting up of the SDR facility was due in no small measure to the active support of, first, the Dillon-Roosa team, followed by the Fowler-Deming team.

There are two reasons why American leadership cannot be dispensed with. The size of the United States' international transactions and the resulting special position of the dollar, speak for themselves. The second reason is the conservatism in monetary matters that has been displayed by France for almost two centuries. One can welcome this conservatism or deplore it, acclaim it or reject it, but one cannot deny it. The French position on monetary matters since the beginning of the last century has consisted of a continuous defence of the status quo, even if that situation has been reached in the face of French opposition at an earlier stage. Some examples: When in the nineteenth century the evolution was to switch from bimetallism towards the gold standard, France stood in the breach as a strong defender of the existing bimetallism. When subsequently, despite initial resistance, the so-called limping standard had gained acceptance in France, the French authorities were unwilling to contemplate any further changes. When, in more recent years, France had nevertheless accepted gold, but other countries wanted to institute a monetary structure more in harmony with modern economic management, it was France that became the staunchest defender of gold. And there have already been instances in which France has defended the SDR system, now that it exists, against proposals for its further evolution. As a consequence of this character trait, every proposal for monetary reform meets with strong resistance on the part of France, which cannot be overcome within the circle of European countries, but only in a broader context under U.S. leadership. A further contributing factor is that, at least until recently, Germany has shown a tendency to adapt itself to the French point of view in deliberations in the Common Market, but to concur with the American position in trans-Atlantic meetings. Its precarious external financial situation and its isolated position outside the Common Market have generally prevented the United Kingdom during the past decade from making its voice heard in the international monetary councils.

But at this crucial point in time, when the international monetary evolution clearly stands at the crossroads, and a choice has to be made between a continuation of the international co-operation which has proved so fruitful since 1945, and the disintegration of the world into contending economic, and in the long run also political blocs--at this moment U.S. leadership is failing its part and the U.S. authorities persist in what they consider to be a policy of benign neglect. In the international sphere, the new economic policy consists of two measures, both negative in character: (1) the suspension of the convertibility of the dollar into gold, and (2) the introduction of the surcharge (and the buy-American provision of the investment credit).

The first measure, which had to lead to fluctuating exchange rates for the principal currencies, was understandable. As explained above, under the system that was in effect until August 15 there was no possibility of a direct devaluation of the dollar in terms of the other currencies. Therefore, an interim period of negotiations, and hence of fluctuating exchange rates, was, in practice, probably unavoidable. But, although the American President announced on August 15 that 'we will press for the necessary reforms to set up an urgently needed new international monetary system', the world is still completely in the dark as regards the nature of the reforms the U.S. government has in mind. There is nothing to indicate that the American authorities dispose of a well-defined plan for the monetary relationships of the future.

The tasks ahead

As a consequence, U.S. policy in the international economic sphere is presently marked by the absence of a vision as regards the future monetary order, and the policy pursued threatens to lead to the disintegration of the world into contending blocs, a disquieting picture. On the one hand, the country has resorted to a protectionist measure in the trade field which is bound to give rise to protectionist counter-measures sooner or later. On the other hand, the policy pursued in the monetary field threatens to lead to the disintegration of the world into contending blocs. The picture is disquieting. However, it is too early to abandon hope. In a country that has consistently pursued for the past 35 years the policy initiated by Cordell Hull, aimed at achieving a free multilateral trade and payments system, there is too much awareness of the political consequences that the coming into being of contending economic blocs will entail. And, although we have not reached the stage of the extreme nationalism of the thirties, the danger of definitely unpleasant nationalistic tendencies has become too real to be neglected.

Consideration should indeed be given to a possible adaptation to the new circumstances of the American role in international economic affairs. A reduction of the dominant role of the United States and of unilateral American decision-making with regard to world-wide problems--with the concomitant unilateral burden of responsibility for carrying out the decisions made--does fit in with the new American posture on foreign relations known as the Nixon doctrine. But an abrupt abandonment of the constructive U.S. post-war policy, a casual and inconsiderate relapse into economic isolationism, is not in keeping with this doctrine. 'Our new policy calls for a new form of leadership, not abdication of leadership,' is a way the American President has described the new approach to foreign policy.1/ And a process of decision-making, aimed virtually exclusively at serving American interests, without consultation with the partner countries--a go-it-alone policy--does not fit into the general picture either. 'Its (the Nixon doctrine's) very nature calls for continuing dialogue abroad and at home'.2/ With American leadership in international economic affairs adapted to the new circumstances, but reinforced and more constructive precisely because of that adaptation to reality, the alternative discussed earlier, namely that of a common effort towards the further development of the system initiated at Bretton Woods, would become feasible once more.

At the same time, serious thought should be given in Europe as well to the essentials of the policy to be pursued in international economic and monetary matters. With U.K. entry into the Common Market and the rehabilitation of the country's external finances, with a Germany that is gradually coming to grips with its own past and ready to play a more prominent role, perhaps also with gradual changes in French foreign policy, new opportunities will present themselves and international relationships are changing. Europe will have to develop its own policy objectives in international monetary matters. Those objectives will have to be situated somewhere between the two poles of following in the American wake on the one hand, and of taking a purely dogmatic anti-American stand on the other--two extremes towards which the European position in international monetary affairs has tended too much thus far. But beyond this, a new dimension must be incorporated

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1/ U.S. Foreign Policy for the 1970's, A Report to the Congress by Richard Nixon, President of the United States, February 25, 1971, p. 17.

2/ Ibid, p. 20.

into the shaping of the European position. It cannot limit itself exclusively to defending European interests, but will also have to take a stand on a constructive evolution of the international monetary order from the point of view of the interests of the international community as a whole. This will require a creative effort. According to a U.S. state department study of a few years ago, only one country outside of the United States had a fully worked-out position on world political problems at that time; in most cases, a country's interest in the sphere of foreign policy was limited to its problems or points of controversy with a few neighbouring countries. However, in the course of the negotiations about the creation of the SDR system a significant start was made on the European side towards such a constructive overall posture in the monetary field.

The monetary crisis comes at a bad moment for Europe, namely at a point in time at which the EEC countries want to make progress toward a monetary union but at which such a monetary union is yet out of reach as a result of the fact that the readiness to accept the required transfer of sovereignty to a European federal body is still lacking. Hence, it is not possible to solve the problems connected with the creation of such a monetary union and the questions now requiring an early decision in the international monetary field at one and the same time. Consequently, the restoration of some degree of international monetary order can neither wait for, nor anticipate the formation of a monetary union among the EEC countries, but on the other hand, it should also avoid putting obstacles in the way of such a development at a later stage. European monetary affairs would thus equally benefit from a decision to base the international monetary order on a neutral, internationally created and regulated intervention and reserve medium that would leave open all options for further European monetary integration.