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Time for a Return to the Charter

by

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It is now 12 years since governments--in the Group of Ten key nations--began to talk about international monetary reform. It is two years since governments--this time in the Committee of Twenty, which was anything but what its name suggested for, with advisers and other officials, up to 200 people were reportedly present at its deliberations--began to talk about creating a brave new monetary world by mid-1974. But a "new" international monetary system did not spring forth, full blown, like Athena from the head of Zeus. The monetary package announced by the Twenty at their final meeting in June 1974 was modest.

The failure was officially attributed to the towering rise in oil prices with its threatened disturbance of the whole balance of payments structure. Understandably, the aftermath of the oil crisis is not an appropriate environment for any reform. But the explosion of oil prices itself has been in large part the consequence of the rapid decline in the purchasing power of the dollar and of sterling, that has undermined confidence in the reserve currencies and in what remains of the organized international monetary system. Thus, inflation is also a basic reason for the failure of the search for monetary reform.

Furthermore, unlike the Bretton Woods negotiators, the Committee of Twenty sought to work out a complete blueprint for a future monetary system. Had the Bretton Woods fathers tried to draw up such a blueprint, the subsequent course of events and developments would certainly not have fitted into their scheme of things. Similarly, the airy fabric of the reformers in the mid-1970s could not have withstood harsh experience.

As a matter of fact, the Committee of Twenty was able to work out a number of technical innovations that governments accepted at least in general and, more often than not, noncommittal ways. But governments failed to agree on substantive matters of exchange rate policy, convertibility and management of global liquidity, including gold. To use the language of the "Outline of Reform," its final report issued in June, the Committee of Twenty agreed on a program of "immediate action" that, as shown below, is principally of a procedural nature, but merely reviewed its discussions of substantive matters. Symptomatically, "a number of areas" within which agreement was not reached were reviewed not in the body of the Committee's report but in annexes attributed specifically to the Chairman and Vice-Chairmen of the Deputies.

Among the institutional arrangements accepted by governments was, first of all, the establishment of an Interim Committee of the IMF Board of Governors that, after an amendment of the Charter, is to become a permanent Council with "the necessary decision-making powers to supervise management and adaptation of the monetary system, to oversee the continuing operation of the adjustment process and to deal with sudden disturbances which might threaten the system." If this body of 27 finance ministers and central bank governors (20 constituents and 7 associates) is capable of working intimately and efficiently on delicate monetary matters, it will mark a step toward supra-national direction of world monetary affairs; if not, it will be the final proof that only the key currency approach--through the Group of Ten or even a Group of Five--is feasible in a politically and monetarily unsettled, suspicious, and divided world. Another institutional arrangement is the establishment of a joint ministerial committee of the Fund and the World Bank to "study" the transfer of real resources to underdeveloped countries and to recommend measures.

Two new monetary instruments are being devised: an oil facility and an "extended" facility of longer-term balance of payments finance to underdeveloped countries. The second of these facilities is still nebulous; the first is to total only $3 billion or, perhaps, $4 billion in a year when the oil-producing countries, which are to lend the money, will have a current account surplus of some $60 billion.

As for SDRs, two innovations became effective on July 1: adoption "for an interim period" of a method of valuation of the SDR based on a basket of currencies, instead of gold, but "without prejudice to the method of valuation to be adopted in the reformed system"; and a rise from 1 1/2 per cent to 5 per cent in initial interest rates on the SDR. The prupose of these innovations is purely pragmatic and quite limited. By setting the SDR afloat, tied to currencies, the Fund hopes to make it usable again; of late, SDRs have been hoarded by governments--like gold. There is no talk of adding to the $10.5 billion worth of SDRs in existence; but renewed consideration is to be given to a link between SDR allocation and development assistance.

The innovations of a procedural nature revolve around the strengthening of Fund procedures for consultation and surveillance of the adjustment process--consultation and surveillance that are to take place at two levels, the Executive Board and the Council described above; establishment of guidelines for the management of floating exchange rates; and elaboration of principles governing controls to limit disequilibrating capital flows.

Disagreements on substantive matters

Disagreements remain on substantive matters, with the Americans vainly trying to reform the Europeans and the Europeans vainly trying to reform the Americans. Most critically, there is disagreement about the very nature of the reformed exchange-rate régime. Ironically, the formula "stable but adjustable par values" was unveiled by the Committee of Twenty just when, in March 1973, the exchange rates of the principal currencies had begun to float freely in the full sense, albeit for only four months. But the formula added that "floating rates could provide a useful technique in particular situations." On the face of it, the formula implies a par value system à la Bretton Woods, with governments more ready to devalue; but Sibyl could not have uttered a more unintelligible riddle. Not too surprisingly, therefore, there is no agreement among governments as to the relative importance of stability of rates.

From this fundamental disagreement stem three deep-seated differences of view. First, there is disagreement about how to establish the need for adjustments in exchange rates. In the U.S. view, increases and decreases in the level of the country's official reserves would as an objective indicator of the balance of payments disequilibrium, call for examination by the IMF. "Disproportionate" changes would indicate an objective need for adjustment, with the Fund calling a recalcitrant government for corrective action. While governments would decide on their own adjustment policies, the Fund could apply "graduated pressure" on them. The U.S. view met with opposition. A reserve loss or gain is not necessarily a sign of fundamental imbalance, for it may originate from cyclical developments, from interest rate differentials or from speculation. Furthermore, the objective indicator formula pointing toward an exchange rate adjustment would inevitably bring about precautionary and speculative buying and selling reminiscent of the worst crises of recent years. Also, the rise in one country's reserves may be merely the consequence of some other country's misdeeds; but because of the size of the U.S. economy and because of the U.S. insistence on the contribution of surplus countries, some of the European governments fear lest the onus of adjustment falls on them rather than on the United States. They advocate discretionary adjustment. Eventually, a compromise was reached under which the need for adjustment would be a matter for "assessment" by the Fund Council, with "major importance" to be attached to disproportionate reserve movements; but this formula is subject to a variety of interpretations.

The second disagreement revolves around convertibility--not the principle that all countries, including the United States, should maintain convertibility of their currency into primary reserve assets of gold and SDRs, but whether the use of dollars (and sterling) as a reserve currency should be strictly limited. The United States takes the view that if the surplus countries were happy to receive dollars, such an option would introduce desired flexibility into the system.

The third disagreement is about the management of global liquidity. Somehow, hopefully, SDRs will become the principal reserve asset, with gold phased out. Somehow, too, the severance of the present link of SDRs with gold and the substantial relaxation of rules governing their use will make them increasingly acceptable to surplus countries. For SDRs to become the principal reserve asset and the principal instrument of reserve growth presupposes that the surplus countries will be willing to accept them as the volume of SDRs becomes larger and larger. It may be that they will accept them as they accepted gold (and almost certainly will accept it again when the matter of its price for inter-governmental payments is settled) and as they accept the present gold-linked SDRs, limited in volume and subject to strict rules and safeguards; but this remains to be seen. The cry, "Gold is dead--long live SDRs" sounds empty at this stage of the monetary evolution.

In mid-June, the Group of Ten was awakened out of a prolonged sleep to accept the practical necessity of allowing hard-pressed Italy to pledge monetary gold as collateral for foreign loans at negotiated prices. This compromise between the desire of the governments of the Common Market's continental members to make renewed use of monetary gold for official settlements at market-related prices and the reluctance of the United States to accept anything that might look like gold rehabilitation is a modest step; but it is something concrete when compared to the suggestion of the Committee of Twenty for "further" study of gold.

Living with the present charter

The chances of a workable compromise about exchange rate policies, convertibility and the management of global liquidity, including gold, are not promising. At Bretton Woods, the United States got what it wanted; today, it can only block what it does not like. As to Europe, influential countries are anxious not to antagonize the United States--England, France, and Italy depend on U.S. private markets and on U.S. official support to finance their balance of payments deficits and all of them, Germany in particular, want the U.S. military presence.

Under the circumstances, the best that can be hoped for is that the governments of Common Market countries, Japan, the United States and Canada will cooperate enough to pursue exchange rate policies that will prove mutually compatible and thus overcome the dangers of the beggar-thy-neighbor postures and policies, which contributed in a major way to the depression of the 1930s. But forced to abandon ambitious plans for a completely new international order, the world outside Russia, China and the countries in their sphere of influence will have no choice but to live with the present IMF Charter.

Surely, the Charter has in recent years been honored more by breach than by observance; but--as the legal framework--it continues to exist. It has at least three advantages of a decisive nature over the reform plans that have now been deadlocked.

First, the Charter is broad and flexible. It stands for stability in exchange rates but makes possible orderly changes in these rates; it stipulates a few rules of good conduct; it requires currency convertibility; and it provides an international monetary facility that has been substantially increased at regular intervals (the fifth increase in quotas is to be made in 1975). Admittedly, governments have on critical occasions defied the Charter; but the fault was not with the Articles of Agreement, but with the unwillingness of governments to live up to them for reasons of prestige or domestic politics. The fatal blow to the Charter was administered in August 1971 by the U.S. Administration, when it suspended--after years of balance of payments neglect that was believed to have worked in the US national interest--what had remained of the formal convertibility of the dollar in gold.

Second, the Charter, while providing liquidity, also circumscribes recourse to the Fund with definite rules, limits and safeguards. Liquidity must not be unlimited for it is this ultimate sanction that makes it necessary for any government to frame its domestic postures and policies with continuing regard to their inflationary repercussions and their consequences for the balance of payments. What is disquieting about an SDR standard is the implicit danger of making domestic inflation comfortable internationally.

Third, the Charter makes it mandatory to adjust the official monetary price of gold in conditions of fundamental imbalance. The Bretton Woods negotiators remembered that haphazard increases in the monetary price of gold in the 1930s--England in 1931, the United States in 1933 and France, Switzerland and the Netherlands in 1936--had a decisive influence on confidence and, hence, on investment and consumer demand, output and employment. In the light of this experience, they accordingly provided for the possibility of concerted adjustments in the price of gold. By refusing to apply this provision of the Charter, the United States has not only inflicted on itself hardships that were really not necessary, but has destroyed the international bullion gold standard, the pillar of the Bretton Woods system.

Today, the reconstruction of the international monetary system will have to start modestly from rules for currency floating. But these rules, which have now been agreed upon by governments in a general way, will be respected only if double-digit inflation is brought under control; otherwise, floating will be even dirtier and there will be more controls on international trade, investment and payments. Action begins at home. But will there be, in the democratic societies, enough discipline and enough willingness to submit to the necessary adjustments to enable the national economies to function efficiently and thus restore and maintain an organized international monetary system?