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Much Ado About International Monetary Reform

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In French author Jules Romain's famous play, Dr. Knock, the central theme concerns a new doctor who convinces an entire, and hitherto healthy, community that each inhabitant is sick. Dr. Knock's basic credo is "Tout homme bien portant est un malade qui s'ignore" which translates, roughly, as "Every well man is really a sick man who doesn't know he's ill." By the end of the play, Dr. Knock has succeeded in being so convincing in implanting this credo that all income earners (to whom he caters) are at home in bed in a darkened room with only a small light on and medicines at hand!

Like Romain's fictional community of St. Maurice, the health of the international monetary system has, it seems to me, often been far too susceptible to the Dr. Knocks of the world with their unnecessary and sometimes even harmful prescriptions. At one point in the play Dr. Knock frightens a prospective patient into believing himself to be a germ carrier by citing evidence that "makes it plain as day, proves by instance upon instance, that a man can go about looking the picture of health, clear tongue, eye bright, appetite excellent, and be carrying in every nook and cranny of his system trillions of germs--poisonous enough to infect a whole county. I have a right to suspect any man I see of being a germ carrier. You now! What is there to prove to me that you are not?"

Just so in the case of the international monetary system. "Instance after instance" or, more recently, "crisis after crisis is adduced in evidence that the entire system is malfunctioning and about to collapse. The same doctors often, perhaps sometimes even deliberately, obfuscate what are the evidences of health and strength, and very real accomplishments, of the system--a system far from perfect but surely not in need of amputative surgery, nor of transplants, nor of quack medicines. What I mean is--not in need of freely fluctuating exchange rates, nor of a wholesale revision of established exchange rates, nor capable of benefiting from a gold price change.

The first question of the Dr. Knocks, however, regarding the health of the international monetary system is, I suppose, the query "What is there to prove that you are not (ill)?" This query has been amplified by the seeming succession of crises in 1967 and 1968. But are those crises symptomatic of the kind of germs in the system that are incapable of eradication without destroying the organism itself? Or are we being victimized, instead, by a repetition of dire prophecies, causing many to assume that deadly germs have taken over the system? Is the system, perhaps, much healthier than generally realized and on its way to even greater strength after overcoming the various strains of 1967 and 1968, and particularly after the new drawing rights in the IMF will have begun to appear?

Here I think that some analysis of the contributions over time of the Bretton Woods system, and an appraisal of the nature of the so-called monetary crises of 1967-1968, shed not a small but a large light on the sustainable health of the system. In fact, as one reviews the accomplishments of the international monetary system that has evolved since Bretton Woods and looks forward to its further strengthening, now so clearly in process and prospect through the creation of Special Drawing Rights, one can find a firm basis for rejecting the idea that the system should be treated as a chronically ill patient. For it can be argued that the several crises in 1967-1968 were basically crises of confidence in the system rather than organic difficulties of the system.

But while one can reject out of hand the notion that the international monetary system needs either dangerous surgery or quack prescriptions, it is clear that further gradual improvement would make the system less vulnerable to the actions of the speculators and to the imperfections (which some might call inactions) of the adjustment process. And it is certainly clear that the adjustment process itself--as each individual country adapts the changes occurring in its internal economy to the necessity for harmonious and viable relations with the economies of the rest of the world--is capable of improvement.

Taking a look back at the usefulness, post-Bretton Woods, of the so-called fixed exchange rate system (or more accurately, perhaps, the adjustable peg system), it is significant that we have had an unparalleled and uninterrupted growth in world income, trade, and payments since its establishment. As the outgoing Council of Economic Advisers pointed out in its most recent Annual Report:

> ".....Remarkable growth in the volume of international commerce has gone hand in hand with sustained world prosperity; each has contributed to the other. At times, deep and obvious strains in the international monetary system have imperiled this progress, but these financial difficulties have been weathered without a serious setback in economic growth or world trade."

> ".....In the years since the Second World War growth has come to be accepted as a normal feature

> of the world economy. It is easy to forget that this was not the case in earlier periods. The depression years of the 1930's present a particularly sharp contrast. But by any historical comparison, the economic progress of the last 20 years is unprecedented."
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> "World income has more than doubled since 1950. In the fifties, growth was especially rapid in the western European countries, while in recent years the United States has grown more vigorously. Japan has experienced rapid and sustained growth throughout the period."

To accommodate this dynamic growth the international monetary system itself has not been static but has undergone flexible adaptation. The resources of the International Monetary Fund have been increased from an initial $8 billion to $21 billion presently, with an additional $6 billion of resources available, if necessary, from a number of industrial countries entering into an agreement to lend these resources (through the General Arrangements to Borrow or GAB). A network of reciprocal currency agreements has been established by the central banks of a number of countries for swaps of each other's currency; the United States new has such swap arrangements, that is mutual credit facilities, totaling $10.5 billion, with some 14 central banks and the Bank for International Settlements.

This growth of reserves and international credit facilities has enabled the international monetary system to function effectively and to accommodate the growth of world trade, payments, and income. Even more importantly, agreement enabling creation, for the first time by deliberate decision, of a new reserve asset (the Special Drawing Rights or SDR's) to supplement gold and dollars ensures that the present monetary system can be fully responsive to the reserve needs of a dynamic and growing world economy.

Then one asks, legitimately, why the seeming succession of crises? One could, I suppose, begin with the sterling crisis of November, 1967 and debate whether or not a credible package of internal and external measures assembled earlier on might have dissipated the crisis of confidence that finally made sterling devaluation unavoidable. One could also, I suppose, ask whether--both in itself, and in the way in which it was handled and contained in terms of immediate impact on other parities--the sterling devaluation did not demonstrate that the international monetary system is indeed quite able to cope with an unusually difficult problem primarily reflecting loss of confidence in a major currency. Again one could give an optimistic reading of the Canadian crisis in February, 1968--a crisis which was purely speculative in nature, and was calmed by public pronouncements of the Canadian and U. S. authorities, reinforced by the conspicuous availability of substantial resources.

The gold crisis of March, 1968 perhaps merits somewhat more elaboration but again, in essence, it was a massive wave of speculation--fed in part by our own successive failures to control the American balance of payments deficits--that forced us all to recognize the need to separate the supply (and the price) of gold in the London and other private markets from the official gold reserves of the monetary system. As I have pointed out before, the policy of maintaining the market price of gold in London had been undertaken originally for the purpose of keeping commercial and private transactions in gold close to the official price, thereby averting or minimizing possible runs on the gold stock. But it had become perfectly clear that this was becoming a one way street for speculators and that the gold pool operations, rather than re-enforcing the credibility of the official price of gold, had, in fact, created a fear that official reserves might be drawn down faster than any acceptable replacement could be found for them. The private speculators had provoked a demand for gold that was feeding upon itself and menacing the continuity of official reserves for the monetary system as a whole.

From this crisis of confidence, however, the system has emerged stronger rather than weaker. For the establishment of the two-tier system for gold was linked directly to the prospective creation of new reserve assets within the International Monetary Fund. As the system continues and is supplemented by SDR creation, gold will be called upon to play a diminishing role, and speculative price movements in the private markets for gold, if they occur, will have less and less relevance to the official price and less and less significance for the monetary system.

The most recent "crisis" in November, 1968--leading to what in retrospect appears to have been an unnecessary and largely unrewarding international monetary conference at Bonn--was again not a reflection of a structural defect or organic malaise of the international monetary system, unless one assumes that official unwillingness to change rates is now a permanently fixed doctrine. In the first instance, it was once more a reflection of the power of market expectations that must be met and absorbed by any system which serves the changing needs of a dynamic world economy. In this case the expectation was that the German mark would soon have to be revalued and that, in turn, this might provoke a devaluation in France or the United Kingdom and set off a chain reaction affecting other countries as well. As my colleague and adviser to the Board, Mr. Robert Solomon, has well stated:

> "The first observation we can make about this crisis is that it was not in any direct way attributable to the nature of the present international monetary structure. The fact that the dollar is widely held as a reserve currency was in no way responsible for the difficulties. (It is notable that the market price of gold barely rose during the eventful week of November 18.) One could imagine a similar crisis--involving expectations of exchange rate changes and the danger of competitive depreciation--in a Jacques Rueff gold standard world or in a Robert Triffin conversion account world in which there is only one reserve asset. In other words, the so-called confidence problem--involving the interconvertibility of two or more reserve assets--had nothing to do with the cause or severity of this crisis. It is one of the many ironies of the events of the last two weeks of November that this international monetary crisis which embroiled France should not reflect the alleged weaknesses in the monetary system that French officials have been pointing to for years." 1/

This bare bones recital of the international monetary system's accomplishments and adaptations--a recital with which you are all too familiar, I am sure--is intended mainly as a reminder of the positive aspects of the present system. The troublesome episodes I have touched on reflected the power of shifting expectations concerning individual countries, when individual countries have differences among them in their policies, their purposes and their performance. Such differences will always occur

1/ (See R. Solomon "Reflections on the International Monetary Crisis, Monthly Review, Federal Reserve Bank of St. Louis, December, 1968.)

so long as the world is dynamic and countries differ. I do not, repeat not, conclude that the system is perfect but I do continue to believe that it is perfectible in the sense that, through further international cooperation, it is capable of being improved and can provide a foundation for sustainable growth in the future. As the CEA noted in its Annual Report:

> "To be sure, the international monetary system has had its problems. Crises have occurred all too frequently. Yet the system has consistently been able to meet the needs of the day, it has evolved and adapted, and it can be strengthened further to meet the remaining strains."

Looking to the future--what can be done to strengthen further the system? An obvious but extremely important first step is to press forward to the realization of the SDR's, to bring them from the world of theory into the world of fact. In the process of ratification, the latest count shows 34 member countries, representing just over 50 percent of the voting power, ratifying the agreement (as compared with the required 67 member countries representing 80 percent of the voting power). Full ratification in the near future, of course, is expected.

An equally important corollary step in improving the functioning of the international monetary system--and vital to the bringing of SDR's into being--is the strengthening of the adjustment process through appropriate internal as well as external policies. For most, if not all, of the confidence crises that I have described reflect insufficient willingness or effort to make the adjustment process effective through either demand policies or exchange rates.

Here the United States' responsibility, as pointed out by Secretary of the Treasury, David Kennedy, is plain. We must contain an inflation that is so damaging to our international position as well as to our domestic objectivies. And our own Federal Reserve role in this effort is clear. The evidence now surfacing in the monetary aggregates, and even in bits and pieces of economic data such as the sales and inventory figures, of the cumulative impact of the gradual but persistent pressure of monetary policy, alongside fiscal policy, should serve as an adequate rejoinder to any possible misinterpretation or skepticism as to our ability and willingness to stay on course.

Before leaving the matter of the adjustment process, I should hasten to point out--as has, I think, been increasingly recognized in our mutually constructive discussions with our counterparts abroad--that improvement of the adjustment process by appropriate policies of individual countries requires not only efforts by deficit countries, but by surplus countries as well.

Related to this, some--mainly academicians--have suggested that another potential source of improvement in the system may conceivably be found in a lessening of the degree of rigidity with respect to the present exchange rate system--both the rigidity of the rates themselves and the rigidity of attitudes concerning the appropriateness of some change in these rates. A variety of suggestions have been put forward for possible further study. One is to explore techniques for introducing greater but still limited flexibility in exchange rates. Another is to explore the technique used in the recent crisis by France and Germany, of adjustment of border taxes and export rebates as an alternative method of improving the adjustment process. 2/ Some of the technical and other problems of a more flexible exchange rate system have recently been outlined effectively by both Dr. Otmar Emminger of the German Bundesbank, and by Dr. Edward M. Bernstein, the former Chief Economist of the International Monetary Fund. Nevertheless, we should remain open-minded and willing to engage in study, objectively and cooperatively, when and where it seems appropriate, of suggestions for improving the adjustment process.

This brings me full circle in my remarks here today. I began by stressing the exposure of the system to the attacks of its critics which have engendered expectations and attitudes inimical to the system itself. Official policies, or lack thereof, cannot escape responsibility for fostering such expectations and attitudes. I remain convinced that the present system can be best improved by gradual change, without abrupt, or dramatic, moves that might in themselves make impossible the continued contributions of the system to continued growth of world trade and payments. As Secretary Kennedy has said:

> "Calm study in cooperation with our friends--not unilateral actions or disruptive changes in the vital role of the dollar and gold--must remain the foundation of real reform and progress in the international financial system.

Appropriate policies contributing to, rather than detracting from, the adjustment process are an integral part of any improvement. Here it is

2/ *Ibid*.

essential to recognize, and to find ways to reconcile, the aims and objectives of the various countries concerned. It is heartening that the OECD is engaged currently in just such an analysis.

Recently someone from the press asked me whether I foresaw in 1969 a repetition of the monetary crises of 1968. In the tumultuous world in which we live conjecture of this sort would be foolish. But in reply I said there need not be and that I was reminded that in his memoirs Winston Churchill records an historic conversation with Franklin D. Roosevelt, in which they discussed what to label World War II. Churchill said that at the time, and for a variety of reasons, he responded immediately, "the unnecessary war."

My own hope, and sincere belief, is that with the continuance of the Bretton Woods system, strengthened by the added dimension of SDR's, supplemented by expanded credit facilities, validated by an improved adjustment process in which the U. S. role is vital, and amended gradually and only after careful explorations in close and calm cooperation with our friends, any international crisis that might develop could only merit the label "the unnecessary crisis."