This is the one hundred and fifteenth number in the series ESSAYS IN INTERNATIONAL FINANCE, *published from time to time by the International Finance Section of the Department of Economics of Princeton University.*

This Essay is unusual. It is a collection of eight brief essays assessing the implications of recent agreements and decisions affecting the international monetary system. The authors are introduced in the Foreword, which describes the origins of this Essay.

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REFLECTIONS ON JAMAICA

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INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS

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FOREWORD

On January 7-8, 1976, the Interim Committee of the Board of Governors of the International Monetary Fund met in Kingston, Jamaica. Immediately after the meeting, I invited fifteen economists to write brief papers commenting on the agreements concluded there and on those reached earlier at the Annual Meeting of the International Monetary Fund in September 1975 and at the meeting of Heads of States and Governments, in Rambouillet, in November 1975. To promise prompt publication of this *Essay*, I had to ask for the submission of manuscripts within six weeks, and some of those to whom I issued invitations were unable to commit themselves to that difficult deadline. Happily, eight of them agreed to do so, and we are delighted to publish their reflections here.

The eight authors whose papers appear here, in alphabetical order, are:

Edward M. Bernstein, President of E M B (Ltd.), who was Assistant Director of Monetary Research in the U.S. Treasury from 1941 to 1946 and Director of Research at the International Monetary Fund from 1946 to 1958. He was Chief Technical Adviser to the U.S. Delegation at the Bretton Woods Conference of 1944.

Richard N. Cooper, Frank Altschul Professor of International Economics at Yale University, who was senior staff economist at the President's Council of Economic Advisers from 1961 to 1963 and Deputy Assistant Secretary of State for International Monetary Affairs in 1965-66. Provost of Yale University from 1972 to 1974, he is currently a Fellow of the Center for Advanced Study in the Behavioral Sciences at Stanford, California.

Nurul Islam, Visiting Fellow at St. Antony's College, Oxford, who was Director of the Institute of Development Economics in Pakistan from 1964 to 1971 and Deputy Chairman of the Planning Commission of Bangladesh from 1972 to 1975. He is a member of the Executive Committee of the Third World Forum and of the Commonwealth Expert Group on the New International Economic Order.

Charles P. Kindleberger, Ford Professor of Economics at the Massachusetts Institute of Technology, who has been a prolific contributor to international financial theory and policy. He is author of three monographs published by the International Finance Section, including *The Formation of Financial Centers: A Study in Comparative Economic History*.

Fritz Machlup, Professor of Economics at New York University, who was Walker Professor of Economics and International Finance at Princeton from 1960 to 1971 and Director of the International Finance Section. He was instrumental in organizing the Joint Conference of Officials and Academics on International Monetary Reform, which has served as an important forum for the exchange of views on international monetary problems since its first meeting in 1963.

Robert V. Roosa, Partner, Brown Brothers Harriman & Co., who was Vice President of the Federal Reserve Bank of New York from 1956 to 1960 and Under Secretary of the Treasury for Monetary Affairs from 1961 to 1964. In that same capacity, he was the principal representative of the United States in the early phases of the negotiations on reform of the international monetary system.

Robert Triffin, Frederick William Beinecke Professor of Economics, Yale University, who served on the staff of the International Monetary Fund from 1946 to 1949 and was with the European Recovery Administration from 1949 to 1951. He is well known to readers of our publications, but best of all for his book, *Gold and the Dollar Crisis*, which opened the debate on international monetary issues that led to the negotiations and agreements discussed in this *Essay*.

John Williamson, Professor of Economics at the University of Warwick, who was Adviser to the International Monetary Fund from 1972 to 1974 and Economic Consultant to the U.K. Treasury from 1968 to 1970.

Although I gave our authors very little time to write their contributions, I placed no restrictions on substance. You will find, then, that some authors have surveyed broadly the issues involved in the recent negotiations, while others have concentrated on special topics or implications. It is an accident of alphabet that this collection opens and closes with broadly based surveys by Bernstein and Williamson. In between, however, you will find detailed discussions of gold, reserves, exchange rates, and the implications for developing countries. I know that you will join me in thanking our contributors for reacting so promptly, yet so thoughtfully, to the Jamaica Agreement.

PETER B. KENEN

THE NEW INTERNATIONAL MONETARY SYSTEM

Edward M. Bernstein

Over the past four years, the members of the International Monetary Fund have been moving gradually toward agreement on a comprehensive reform of the monetary system. The initial work was done by the Committee of Twenty, and their Outline of Reform provided the basic material for discussion of the problems with which the reform was concerned. The process was continued by the Interim Committee of Governors. At its meeting in Jamaica on January 7-8, 1976, the Interim Committee requested the Executive Directors to prepare a comprehensive amendment to the Fund Agreement that would implement their recommendations and constitute the long-sought reform of the monetary system.

The Exchange-Rate Regime

One of the major questions on which it was very difficult to secure agreement was the exchange-rate regime. The Outline of Reform stated categorically that "the exchange rate mechanism will remain based on stable but adjustable par values," with greater flexibility in exchange rates provided through wider margins and simplified procedures for making small changes in par value. Countries could be authorized, however, to adopt floating rates. This preference for a norm of par values was gradually modified in the discussions of the Interim Committee. While France held to the view that the basis for the monetary system should be par values, the United States held that fixed parities depended on the prior attainment of stable monetary conditions.

Experience with the exchange system that evolved after March 1973 showed that the real issue was not the restoration of fixed parities but the excessive fluctuation in certain key exchange rates—specifically, the dollar rates for the currencies in the European common float (the "snake"). As long as the world is confronted by persistent inflation and large imbalances in international payments, there is no alternative to a system of fluctuating rates combined with broad areas of exchange stability. From the point of view of the exchange market, the present system has worked well. It has avoided exchange crises involving the dollar. It has balanced the supply of and demand for dollars in the exchange market. It has had no obviously adverse effect on the volume of world trade. These are not negligible achievements in a seriously unbalanced world.

From an economic point of view, the objectionable aspect of the present system is not that exchange rates fluctuate, but that the dollar rates for some major currencies fluctuate too much. In the past three years, the dollar rates for the snake currencies have risen and fallen alternately by 10 to 20 per cent over periods of three or four months. Such fluctuations cannot reflect changes in underlying economic conditions—differences in relative rates of inflation or in interest rates. They are primarily due to speculative capital flows in anticipation of changes in exchange rates. Such fluctuations distort the pattern of trade. When the dollar is at a peak, the exchange rate imposes an implicit tax on exports and a bounty on imports. When the dollar is at a nadir, the tax and bounty effects are reversed. With these large and erratic fluctuations, the exchange rate cannot perform its fundamental function of bringing about a pattern of trade based on comparative costs and a flow of capital based on comparative profit and interest rates.

The difference in U.S. and French views on the exchange-rate regime was resolved at the Rambouillet meeting in November 1975, when the six largest industrial countries agreed on the need to work for greater monetary stability. In deference to the United States, the communiqué stated that "this involves efforts to restore greater stability in underlying economic and financial conditions in the world economy." And, in deference to France, it stated that "at the same time, our monetary authorities will act to counter disorderly market conditions, or erratic fluctuations, in exchange rates." This cleared the way for agreement at the meeting of the Interim Committee in Jamaica to amend Article IV of the Fund statutes on the exchange-rate regime.

Under the amended Article, members will still have a general obligation to collaborate with the Fund to assure orderly exchange arrangements and to promote a stable system of exchange rates, but the emphasis is shifted to doing this through orderly economic growth with reasonable price stability, which the United States has constantly said are the only bases for exchange stability. A member may follow any of the specific exchange arrangements that prevail today. It may have a par value denominated in SDRs but not in gold or a currency; it may participate in cooperative arrangements which stabilize the exchange rates for a group of currencies relative to each other, as in the snake; or it may follow another exchange arrangement of its choice, such as a fluctuating rate for the dollar.

Provision is made for a generalized restoration of par values by an 85 per cent majority of the total voting power of the IMF. It would thus require the approval of the United States and the Common Market. To do this, however, the Fund must first determine that international economic conditions permit the introduction of a widespread, but not universal, system based on stable but adjustable par values, and no country would be obligated to set a par value for its currency. As further conditions for establishing a qualified par-value system, the Fund would have to be satisfied that there are adequate sources of liquidity and that arrangements are made for prompt and symmetrical action by surplus and deficit countries to accomplish balance-of-payments adjustment, as well as arrangements for intervention and the treatment of imbalances, which may mean modes of settlement. These are not conditions likely to be fulfilled in the next few years.

It may seem that the amended Article on the exchange-rate regime has no practical significance because it does no more than legalize the existing exchange system and recognize the need for greater exchange-rate flexibility. But even that is of considerable importance. As it has become clear in the past few years that the world economy cannot be adapted to the system of fixed parities, it is necessary instead to adapt the exchange system to the realities of the world economy. In practice, the amended Article may give the Fund considerable influence on the exchange-rate policies of its members. After all, there must be something more to the general obligation to collaborate with the Fund and other members in assuring orderly exchange rates and promoting a stable exchange system than merely to foster orderly underlying financial and economic conditions.

The amended Article is directed as much to countries with fluctuating exchange rates as to those with par values. The Fund is required to oversee the international monetary system and the compliance of each member with its obligations on exchange rates. To fulfill this function, the amendment states that the "Fund shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies." Under this provision, the Fund could adopt guidelines on fluctuating rates that would place responsibility on members to avoid erratic and excessive fluctuations and to moderate such fluctuations when they are not caused by changes in underlying economic conditions. The responsibility cannot be one-sided, and intervention to prevent erratic and excessive fluctuations would have to be made only after consultation with the Fund and in cooperation with other members whose currencies are involved.

Gold and SDRs

The outline of Reform stated that "the SDR will become the principal

reserve asset and the role of gold and reserve currencies will be reduced." As in the case of exchange rates, the difficulty in securing agreement on gold was the difference in the views of the United States and France, mainly on the right of monetary authorities to engage in gold transactions at market-related prices. In the course of its discussions, particularly at the fourth meeting in August 1975, the Interim Committee agreed on abolition of an official price of gold, elimination of the obligation to use gold in transactions with the Fund and the Fund's authority to accept gold, the sale of one-sixth (25 million ounces) of the gold holdings of the Fund for the benefit of the developing countries, and the sale (restitution) of an equal amount to members at the official price of 35 SDRs an ounce. The Interim Committee had previously agreed that national monetary authorities should be free to enter into gold transactions under specific arrangements that would gradually reduce the monetary role of gold, and at its August meeting it noted that the Group of Ten had entered into such arrangements.

The amendment to the Fund Agreement will abolish the official price of gold and terminate gold transactions between the Fund and its members. The sale of gold for the benefit of developing countries will be at public auctions over a four-year period, and the restitution of gold to members will be made under the existing powers of the Fund. The amended Fund Agreement, however, will contain enabling provisions under which the Fund could use its remaining 100 million ounces of gold in restitution to members at the present official price or in sales to the market at prevailing prices, using the profits to augment its general resources or to provide balance-of-payments assistance on special terms to developing countries in difficult circumstances. Such further gold transactions by the Fund will require a large majority of the total voting power.

The abolition of an official price of gold puts a formal end to the postwar gold standard, which had in any case ended in August 1971, if not before. The termination of gold transactions between the Fund and its members and the disposal of one-third, and perhaps ultimately all, of the 150 million ounces of gold now held by the Fund would seem to be major steps in reducing the monetary role of gold. On the other hand, the restitution of gold to members, and particularly the arrangements of the Group of Ten with the acquiescence of the Fund, have been criticized as enhancing the monetary role of gold. Under these arrangements, to which other countries may adhere, the monetary authorities of the Group of Ten will be allowed to buy and sell gold at market-related prices, provided this does not involve pegging the price of gold or increasing the total stock of gold now held by the Fund and the Group of Ten.

In spite of the arrangements of the Group of Ten, it is very doubtful that gold will be much used in international settlements. Some central banks may be willing to sell gold when confronted with serious payments problems if they have already run down their foreign-exchange reserves and their access to reserve credit. The more important point is that central banks are unlikely to be ready buyers of gold at market-related prices. They are understandably reluctant to acquire assets whose value in their own currencies is subject to sharp fluctuations. Moreover, unless the United States and other countries are willing to buy gold at market-related prices, central banks may find that the gold they have acquired when they had a surplus cannot be used to settle a deficit. When countries do sell gold to meet balance-of-payments deficits, it will probably be in moderate amounts in the free market, and this would result in a gradual reduction of the monetary stock of gold.

If termination of the monetary role of gold is conceived as requiring its elimination from the reserves of members of the Fund, there is no prospect of achieving this objective at any time in the foreseeable future. Apart from the fact that gold retains a mystique of its own, so that some central banks like to show gold holdings on their balance sheets, there is the problem of what to do with the present stock, about 1 billion ounces, held by countries outside the Communist group. When silver was demonetized, central banks hastened to sell most of their holdings in order to buy gold. Now, there is no asset that central banks would prefer to acquire in place of gold. They may sell minor amounts in the free market from time to time to acquire needed foreign exchange or to meet domestic industrial demand. The great bulk of the present monetary stock of gold, however, will remain at the bottom of the reserve pile, part of the national patrimony but not to be used except under extreme stress.

It has been suggested that the simplest way to eliminate gold from reserves would be by establishing a substitution account in the Fund through which members would be able to exchange part or all of their gold holdings for SDRs issued by the Fund for this purpose. As a practical matter, no country would exchange its gold for SDRs at the official price. Nor would any country make the exchange at a market-related price unless it became necessary to sell gold to meet a payments deficit and it found an exchange for SDRs a convenient method of doing this. The truth is that SDRs have not yet acquired the degree of international acceptance where countries would prefer to hold them instead of gold or even instead of currencies. At Jamaica, the Interim Committee asked the Executive Directors to continue considering a substitution account for

gold, but without delaying completion of the comprehensive amendment. This may be regarded as a polite way of burying the issue.

The Outline of Reform stated that the SDR would become the numeraire in which par values were expressed. The first step in this direction was taken on July 1, 1974, when the definition of the value of one SDR was changed from 1/35 of an ounce of gold to specified amounts of a basket of sixteen currencies. This has provided a convenient basis for denominating the par value of the currencies of countries that want to avoid the wide fluctuations in the exchange rates for the dollar and sterling relative to the snake. As the dollar was one-third of the initial value of the new SDR, and a few other currencies in the SDR basket change relatively little in terms of the dollar, the dollar value of the SDR has fluctuated within a moderate range of 3.5 per cent below and 4.5 per cent above its initial value. Only about twelve countries now maintain the exchange rates for their currencies in terms of the SDR. The amendment to Article IV will make the SDR the common denominator of par values unless some other numeraire is adopted.

The statement that the SDR will become the principal reserve asset is more a hope than a practical possibility. At best, the importance of SDRs will grow gradually as further issues are made. The immediate task is to give the SDR the characteristics of a freely usable reserve asset. That will be done in the comprehensive amendment. The Fund will have wider authority to designate institutions eligible to hold SDRs. Members of the Fund will be free to deal in SDRs without designation and without showing a need to use them in payments settlements. In short, countries will be able to change the composition of their reserves between SDRs and reserve currencies in much the same way as in the past as they could change between gold and currencies. The improvement in the reserve character of the SDR will have to be followed by a resumption of their issue if they are to become a significant part of total reserves.

Resources for the Developing Countries

The Outline of Reform stated that, in the light of the agreed objective to promote economic development, the reformed monetary system will contain arrangements to help increase the flow of real resources to developing countries. One suggested method was to link the issue of SDRs with development finance, either through direct distribution to developing countries of a larger proportion of SDR issues or through allocation of a share of SDR issues to international and regional development institutions. The assumption, of course, was that, even with the link, the issue

of SDRs would be determined exclusively by the need for a trend growth of aggregate reserves. The Interim Committee reported a diversity of views on the link, but agreed to keep the matter under active study and at the same time to consider other ways of increasing the transfer of real resources to developing countries. As the Committee has now recommended other ways, the link may be regarded as moribund.

At the meeting in Jamaica, the Interim Committee endorsed the long-standing recommendation of the Executive Directors for a 32.5 per cent increase in quotas, rounded up to SDR 39 billion. The quotas of the oil-exporting countries will be doubled, those of other developing countries increased proportionately with the total, and those of the industrial countries increased less than proportionately. The comprehensive amendment will provide for a triennial rather than quinquennial general review of quotas. The amendment will also provide that the Fund's holdings of each currency should be usable in its operations in accordance with its policy—presumably, when the country has a payments surplus. In the next six months, members will have to make satisfactory arrangements for the Fund's use of their currencies before the amendment comes into effect.

These measures reflect recognition of the relatively greater need for reserve credit by developing countries because of their generally smaller holdings of reserves and the sharp fluctuations in their payments position. That recognition was one reason why the Fund established a compensatory financing facility over ten years ago on which countries could draw to meet the shortfall in their normal export receipts. Since this facility was established, thirty-one developing countries have drawn reserve credit of $1 billion in compensatory financing. The Interim Committee showed particular interest in increasing the availability of resources through this facility, and it was decided that the Fund would be prepared to authorize drawings up to 75 per cent of a member's quota (previously 50 per cent), provided outstanding drawings were not increased by more than 50 per cent of the member's quota (previously 25 per cent) in any twelve-month period. Larger drawings may be made only if the Fund is satisfied that measures are being taken to deal with the member's payments problem.

The most important new step taken by the Fund to help developing countries is the establishment of the Trust Fund for their benefit. The resources of the Trust Fund will come from the profits on the sale of the Fund's gold, augmented by voluntary national contributions. Some countries have already stated that they will make such voluntary contributions. The resources of the Trust Fund may be increased later by the profits

on additional sales of gold, although that cannot be for four years, that is, after the first 25 million ounces are sold, and then only by a large majority of the total voting power. The Trust Fund will be used to provide balance-of-payments assistance on concessionary terms to low-income countries, initially those with per capita income not in excess of SDR 300 in 1973. The establishment of the Trust Fund will not require amendment of the Fund Agreement.

Role of the Fund

What will be the role of the Fund as the international monetary authority? Like most questions about the changes in the Fund Agreement, the answer will depend more on practice than on theory. The amendment says that "the Fund shall oversee the international monetary system." Taken by itself, this is a broader statement of the authority of the Fund than is contained in the Bretton Woods Agreement. The Fund will have less rigid statutes on the exchange system, but it will have wider powers to adopt and supervise guiding principles on exchange policy. As a financial institution providing reserve credit, the Fund will become more important than ever. This may enhance its influence over members that come to the Fund for assistance. Ultimately, the role of the Fund will depend on what its members want it to be. That will depend mainly on the new Council of Governors, the successor to the Interim Committee. The experience with the Interim Committee showed that it could make decisions that members accepted with minimum delay because it included the highest treasury and central-bank officials. If the Fund has the confidence of the Council, it will grow steadily in stature as the international monetary authority.

MONETARY REFORM AT JAMAICA

Richard N. Cooper

The last year has seen numerous high-level conferences on the functioning of the world economy. A Special Session of the United Nations General Assembly was devoted to it in September 1975. The heads of state of six leading nations met at the Château de Rambouillet in November 1975. The Paris meeting between oil-producing and oil-consuming nations met in December, with an agenda that went way beyond oil. And, in January 1976, the Interim Committee of the International Monetary Fund met in Jamaica. The frequency and the high-level participation at such meetings testify to the turmoil prevailing on the world economic scene. At issue are the international monetary system, resource scarcity and prices, transfers of resources to the poorest nations, and the short-run performance of the world economy. The Rambouillet meeting was ostensibly concerned primarily with the last of these issues, while the Jamaica meeting was concerned with the first. But, in fact, each issue intruded strongly on the others.

The Jamaica meeting was distinguished among these conferences by having led to concrete, substantive decisions. It addressed the regime of exchange rates among countries, the disposition of gold in the international system, and the enlargement of lines of credit to developing nations.

A New Regime for Exchange Rates

The Jamaica Agreement legitimized flexible exchange rates. Once ratified, the new Article IV of the Articles of Agreement of the International Monetary Fund will make "legal" prevailing practices that are not permissible under the original Bretton Woods Agreement, still formally in force though in fact in abeyance.

The new Article IV pays obeisance to exchange-rate stability and even envisages a time when fixed parities can be re-established "on the basis of the underlying stability of the world economy" and with an 85 per cent majority of the total voting power of the IMF. (This percentage was chosen to permit either the United States or the European Community to block such a restoration.) But the language is carefully chosen. Countries pledge themselves "to promote a stable system of exchange rates," not a system of stable exchange rates. And they are to "seek to promote sta-

bility by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions," thus implying that "unstable" exchange rates are a consequence of unstable underlying conditions rather than a failure to fix the rates. The new Article in effect allows each country to have any regime of exchange rates that it wants, subject only to the conditions (a) that it notify the IMF of its arrangements and (b) that it "avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members."

Having legitimized a system of flexible rates, the Jamaica conferees left open all the difficult problems of actually managing a system of flexible rates. I take for granted that governments will intervene from time to time in the foreign-exchange markets. All major governments are now held responsible for managing their economies, and this can hardly encompass total abstention from directly influencing an economic variable as important for most countries as the exchange rate. We therefore need supplementary provisions for coordinating both the objectives of intervention and the actual practice of intervention, so that two countries do not find themselves working at cross-purposes on the same exchange rate.

For most countries formal coordination will not be necessary, since they can rely on their small size relative to the world economy and can frame their intervention policies against some major currency or bundle of currencies (such as the sixteen-currency SDR). For the sake of overall economic stability, however, there must be some mechanism for calling into account countries that either strongly undervalue or strongly overvalue their currencies, in accordance with the limited stricture on exchange-rate regimes noted above.

For major countries, coordination of exchange-rate policies needs to be more explicitly cooperative, since stability of the world economy can be aided by avoiding erratic movements in exchange rates among major currencies. Guidance for intervention should involve two components, in my judgment: (a) avoiding rapid rates of change in exchange rates, except when they are manifestly necessary owing to rapid and unexpected changes in underlying conditions, i.e., assuring orderly markets, as we try to do with money and bond markets and in a more limited way with commodity markets, and (b) linking intervention policies to national levels of international reserves to assure that exchange rates are not allowed to deviate very far from the rates that would clear the market without intervention over a period of time, i.e., requiring that if reserves are built up or run down relative to desired levels (which would have to be established) as a result of intervention designed to smooth movements in exchange rates, the direction of intervention should be reversed when market conditions permit so as to move reserves back to the desired levels. Reserve management, in other words, should be similar in character to ideal buffer-stock management or to monetary management, which involve short-term price targets and long-term volume targets.

The Jamaica Agreement leaves all these important operating details to be worked out. No doubt they will be worked out on the basis of practical experience in the next few years.

Disposition of Gold

Amending the IMF Articles to permit exchange-rate flexibility is a good step. But it merely legitimizes the status quo and represents no real innovation. Currencies must of necessity float for some time to come. The agreement on gold, in contrast, introduces an important innovation. In an arrangement that is a variant of one that Professor Kaji, Dr. Segré, and I proposed to the Trilateral Commission in Tokyo in 1973 (Motoo Kaji, Richard N. Cooper, and Claudio Segré, *Towards a Renovated World Monetary System*, The Triangle Papers No. 1, New York, The Trilateral Commission, 1973), the IMF will sell one-sixth (25 million ounces) of its substantial gold holdings on the private market and will devote the capital gains from such sales (the difference between the price it fetches on the market and the official price of $42.22 an ounce) to helping the poorest countries of the world, especially those that have been hit hardest by the increase in oil prices and the current world recession. Estimates differ on how large the gains will be, but if the average price of these sales is $100 an ounce (compared with a current market price of around $140 an ounce), then the total gains will be about $1.5 billion, spread over the four years of the projected sales. This is not a huge amount, but it will help significantly, particularly if it can be used as leverage for larger amounts of private or official funds, for example by subsidizing the interest rates on World Bank loans.

The agreement on gold is deficient in two respects. First, although the new draft Article IV does specifically exclude the use of gold as a basis to which monetary values are tied, the agreement does not settle the issue of monetary gold for the future; further understandings will be necessary, particularly on the extent to which central banks may buy or sell gold. In addition to the one-sixth of the IMF gold to be sold on the market, for instance, a further sixth is to be redistributed to member countries. What are they to do with it? That is not settled. Provision

is made, however, for a procedure to decide on the disposition of the remaining IMF gold.

Second, the agreement to sell one-sixth of the gold is marred by a side understanding that, in one fashion or another, all "developing" countries will get their prorated share of that gold, at market prices. Thus the capital gains available for distribution to the poorest countries will arise only from the share (about two-thirds) that was originally subscribed to the IMF by "developed" countries. In effect, moderately wealthy countries such as Argentina and Venezuela have refused to aid in this fashion such desperately poor countries as Chad and Bangladesh, even though the arrangement would have involved no direct cost to them. There is, of course, an opportunity cost, in the language of economists, but that exists for developed countries as well. The precedent is a bad one and has not been missed in the developed countries. France in the end abandoned its position that all the IMF's gold should be returned to its original subscribers. But Australian officials have been heard to mutter that perhaps they should withdraw from the IMF to get their gold, and two American Senators have introduced a bill in Congress that would insist on distribution to original subscribers (fortunately, the bill has little chance of passing).

Earlier suggestions by developing countries that major central banks should buy the gold to prevent the market price from falling (and hence to increase the capital gains) happily were overtaken by sounder judgment at Jamaica, when it was realized that in the long run such an action would probably kill the Special Drawing Rights of the IMF, which are more important to developing countries.

Financing World Economic Recovery

The central concern of the Jamaica meetings, however, was the state of the world economy, and rightly so. Economic recovery seems to be taking place, but it is limping rather than leaping ahead. The American economy will probably grow by 5 to 6 per cent in real terms during 1976, the weakest initial postwar recovery year by far, and Europe will grow even more slowly during the next year. The weak recovery means that the earnings of primary producing countries—many less developed countries plus countries such as Australia and Finland—will remain low. And it means also that sectoral protectionist pressures in the industrialized economies will remain high. Protectionist moves, such as Britain's recent restrictions on imports of textiles, will reduce the earnings of those developing countries that have been successful in selling manufactured goods on the world market.

Moreover, many countries of the world, including the smaller industrial countries as well as non-OPEC developing countries, have experienced an alarming growth in external debt. Indeed, these countries have been supporting world economic activity, particularly the production of equipment, by their heavy borrowing—an example, to paraphrase Keynes, of national vice being international virtue. But the outstanding debt has now reached staggering proportions—probably $160 billion for the non-OPEC developing countries alone, nearly twice the level of late 1972, and rising by perhaps another $25 to $30 billion in 1976, *if* the financing can be found. (While world inflation has eroded the real burden of debt outstanding before 1973, the rise in interest rates and in outstanding debt far outstripped world inflation in 1974 and 1975.) This magnitude of borrowing is not likely to continue, for both borrowers and lenders have become extremely uneasy about it. If developing countries are not to cut back their imports significantly, and thereby set back world economic recovery, the receipts of these countries must be greatly increased. The best way to do this is through a more vigorous world recovery.

Faster recovery could take place in most industrial countries without threatening faster inflation. Unemployment is at a postwar high in all the major industrial countries, and capacity-utilization rates are low. Faster recovery would raise primary-product prices, but it would not raise the prices of finished goods appreciably faster than they will rise anyway, for cyclical productivity increases would result in lower average costs despite higher materials prices.

The economic summit meeting at Rambouillet paid lip service to faster recovery, but in fact most of the corridor talk reflected a preoccupation with inflation. President Ford's veto of a bill to extend 1975 tax cuts into 1976—although later reversed—reflected the same preoccupation. Inflation unquestionably is a serious problem, but it is not susceptible to easy remedy and it is not very sensitive to the rate of recovery in 1976 within quite a broad range; the recovery could be nearly twice as fast as its current projection in the United States and still not have much effect on the rate of inflation, for unemployment would remain above 6 per cent of the labor force into 1977. To be sure, such a rapid recovery would require a significant deceleration in 1977. Faster recovery would both raise the volume of exports from developing countries and improve the terms of trade of primary producing countries.

The alternative, if cutbacks are to be avoided, is more loans. But whence? A key decision at Jamaica, taken at the behest of developing countries, was to extend temporarily the credit tranches of the IMF by 45 per cent, pending the coming into force of an increase in total IMF

quotas to $49 billion, also agreed at Jamaica. Each member country would be able to borrow that much more than it can now. The total amounts are not large—some $4 billion for all less developed countries—and to some extent merely replace the expiring Oil Facility. But they presumably will also permit somewhat greater borrowing from the private sector.

In the absence of faster recovery and/or additional loans, world recovery will be delayed by declines in sales to developing countries; more serious, the liberalization of trade that has been so painstakingly accomplished in many less developed countries over the past decade will receive a grievous setback, as one country after another feels forced to restrict imports for balance-of-payments reasons. Korea and Brazil have already started in that direction. If deliberalization becomes widespread, it will take another decade to undo it. Domestic political resistance to trade liberalization is high, and because trade negotiations now exempt developing countries from reciprocity in trade liberalization, there are few offsetting domestic pressures.

The Jamaica meeting accomplished some important long-term objectives. It ignored other questions, such as the long-run role of the SDR and of reserve currencies, and the Eurocurrency market. But its most remarkable achievement was that finance ministers not only discussed the world economic scene together but actually took some action, in the form of gold sales and credit liberalization, to do something about it. If a crude analogy to national central banking may be made, IMF gold sales mark the beginning of international open-market operations (though in the present instance motivated by the prospect of usable capital gains rather than a desire to reduce currency holdings in the hands of the public), and liberalization of the IMF credit tranches represents the beginning of international rediscount policy. Jamaica may mark the introduction of a more coordinated approach to global economic policy.

JAMAICA AND THE DEVELOPING COUNTRIES

Nurul Islam

The decisions taken at the Jamaica meeting of the Interim Committee of the International Monetary Fund represent a milestone in the international monetary reform which has been under negotiation for about a decade. By the 1970s, a broad consensus seemed to have emerged on the main components of a new international monetary order, on the following lines: Gold and reserve currencies were to be replaced by a central reserve asset in the form of SDRs; an increasing degree of collective management of and control over the creation of international liquidity was to be established; exchange rates were to be stable but adjustable more frequently and with greater flexibility than in the past; and there was to be a symmetrical obligation on the part of surplus and deficit countries to undertake domestic adjustment, including exchange-rate changes.

The years between 1970 and 1975 saw extraordinary and abrupt changes in the international monetary scene. These were characterized, on the one hand, by an intensification of worldwide inflation and, on the other hand, by floating exchange rates for all the major currencies. Considerable inflationary pressure was generated by massive creation of liquidity through large-scale deficits in the balance of payments of the reserve-currency countries and was subsequently accentuated by the quadrupling of the price of oil. There was a dramatic shift from the industrial world to the OPEC countries in the distribution of holdings of surplus reserves. The non–oil-producing developing countries were particularly hard hit by inflation and by recession in the industrial countries, as well as by falling terms of trade. The share of the developing countries in the increase in liquidity during the last four or five years was meager, i.e., no more than 3 per cent of the additional reserves, and 90 per cent of the increase in their reserves consisted of IMF credits and SDRs. The increase in the balance-of-payments deficits of the developing countries, in spite of a decline in their growth rate, was large. It was met only by a combination of measures such as depletion of foreign-exchange reserves, emergency assistance of the United Nations, regular and Oil Facility drawings from the IMF, borrowings from private banks and capital markets, and OPEC and OECD long-term public aid.

The Jamaica Agreement constituted a response to the unfolding debate on the appropriate system of international liquidity and of exchange rates;

it was also partly a response to recent developments in the world monetary situation, especially the plight of the non-oil-producing developing countries. The short- and long-term issues were interrelated, particularly for the developing countries. In the following comments, the interests of the developing countries in international monetary reform and the ways in which recent changes affect their present position and future prospects will receive particular but not exclusive attention.

Gold and International Liquidity

The Jamaica Agreement eliminates the official price of gold and abolishes the obligations of the members of the IMF to use gold in their transactions with the Fund. It is understood that the central banks of the Group of Ten will neither peg the price of gold nor increase their holdings of gold through purchases in the private market. Elimination of the official price of gold is expected to discourage the holding of gold as a reserve asset because of fears that its value will depreciate and because there is no guaranteed mechanism for converting gold into other reserve assets, including SDR and IMF credits. But, at the same time, the Fund is authorized to restore to its members at any time in the future some or all of its remaining gold holdings, at the present official price and on the basis of present quotas.

Admittedly, the amended Article will contain the famous "collaboration clause" on the future role of gold, obliging each member to collaborate with the Fund and the other members in order to "ensure that their policies with respect to reserve assets would be consistent with the objectives of promoting better international surveillance of international liquidity and making the Special Drawing Rights their principal reserve asset in the international monetary system." However, there still remains practical uncertainty regarding the future role of gold as a reserve asset. Many countries may be reluctant to dispose of gold in the immediate future; the absorptive capacity of the private gold market, with its speculative behavior, remains uncertain (see H. J. Witteveen, "The Control of International Liquidity," *IMF Survey*, Oct. 28, 1975). The increase in the monetary value of central-bank gold holdings consequent on valuation at the free-market price of gold could create, depending upon the reaction of the central banks, an inflationary potential of a large magnitude. The return by the IMF of one-sixth of its gold holdings to the member countries, in proportion to their quotas, which adds disproportionately to the gold holdings and liquidity of the more developed member countries, is not only highly inequitable but also unduly enlarges the role of gold in their reserves. (The countries with the largest official gold holdings are the

United States, Germany, France, Switzerland, Italy, and the Netherlands. Their reserves would be greatly increased. The developing countries' official gold holdings do not exceed 10 per cent of total official gold holdings.)

A really effective way of reducing the role of gold would have been to establish the long-discussed "gold-substitution account" under which member countries were to surrender their gold holdings to the IMF in exchange for SDRs, either at the official price or at a negotiated price between the official price and the free-market price. The Fund in its turn could dispose of the gold holdings over a number of years without disrupting the private gold market. Even though a drastic reduction in the role of reserve currencies is crucial to making SDRs the central reserve asset, no decision was taken at Jamaica for the consolidation of the current holdings of reserve currencies by exchanging them against SDRs and then having the reserve-currency countries redeem the currencies by issuing long-term debt instruments to the Fund. This would undoubtedly raise the familiar questions as to the rate of interest, the period of amortization, and protection of the debt instruments against inflation. However, there are alternative ways of establishing international control over liquidity without a drastic reduction in the role of reserve currencies, provided the central banks agree to hold a minimum proportion of their reserves in the form of SDRs, so that adjustments in the total volume of SDRs and/or changes in the SDR proportion would bring about a change in the volume of liquidity. This would require a harmonization in the composition of international reserves among the various countries of the world.

It is obvious from the above that the establishment of international control over the creation of liquidity is still far away; the situation is further complicated by the very considerable expansion of liquidity under the control of the private international banking sector, including the Eurocurrency market, which has grown in the past four years at an annual rate of 30 to 40 per cent.

Quotas and Drawings

While there has been an "explosion" of liquidity through the export of reserve currencies, the intercountry distribution of liquidity has not been in general conformity with needs, and its distribution in particular has been skewed in favor of the developed countries. An earlier agreement to undertake an upward general revision of quotas of the Fund by 32.5 per cent was confirmed at Jamaica. The share of the industrialized countries was reduced from 73 per cent of the total quotas to 68 per cent,

that of OPEC members increased from 5 to 10 per cent, and that of the non-oil-producing developing countries left unchanged at 22 per cent. Until the increases in quotas are implemented, possibly in one and a half to two years' time, the members have been granted drawing rights of an additional 45 per cent of the existing quotas, in each of the credit tranches. The largest additions to liquidity under this system accrue to the largest quota holders and not necessarily to those who are in greatest need of additional liquidity. (The largest quota holders are the United States, the United Kingdom, Germany, France, Japan, Canada, and Italy, in that order.) Exceptions in excess of 45 per cent would be permitted for countries in very difficult circumstances, and a further general increase beyond 45 per cent would be considered in the short run, if the general situation further deteriorates. But the temporary increase in access to Fund resources of 45 per cent is higher than that of the upward revision in quotas of 32.5 per cent already agreed upon. Thus, in two years' time, access to drawing rights may actually be reduced below the present level.

The use of quotas as the basis of drawing rights involves anomalies and inequities in the distribution of additional liquidity. This is inherent in the way in which Fund quotas have been used to perform multiple functions that are not always mutually consistent. The quotas not only determine (a) the relative access to international liquidity but also are used as (b) a measure of the capacity to provide international credit and (c) a measure of weight in the decision-making process of the Fund. While the OPEC members certainly require larger quotas to exercise a weight commensurate with their relative importance in world trade and investment, they certainly do not require larger access to international liquidity. The developing countries have been pressing for larger quotas unrelated to their economic and financial strength not only for a larger access to credit but also in an attempt to democratize the decision-making process. The Jamaica Agreement, which would require 70 to 85 per cent of the total votes for a few crucial decisions, would give greater voice to the developing countries, including the OPEC countries, inasmuch as they control 32 per cent of the total votes whereas the developed countries control 68 per cent of the total votes. So long as Fund quotas continue to combine multiple functions in the future, the developing countries' access to Fund resources should be expanded by allowing them to draw a larger percentage of quotas than is allowed to the developed countries under various credit tranches.

Aside from the extraordinary circumstances of the last three years, a greater need for liquidity by developing countries even in relatively normal times has been increasingly emphasized. This is due to their higher

costs of adjustment, limited access to private banking and capital markets, greater variability of exchange earnings, and higher opportunity costs of holding foreign-exchange reserves. In the past, their total drawings from the Fund have been much larger than those of the developed countries, even though the latter had much larger quotas; the IMF had often to invoke a "waiver" clause in postponing repayments by developing countries.

The conditions attached to borrowing from the various credit tranches of the Fund have been subjected to increasing criticism by the developing countries. The Group of Twenty-four (developing countries), in its Jamaica meeting, resolved as follows:

> 1. Ministers expressed strong support for a substantial enlargement, on a permanent basis, of the access of the developing countries to Fund credit. They advocated the immediate addition of two credit tranches with the same conditionality as the first credit tranche;
>
> 2. Ministers agreed that the conditionality attached to the use of Fund's resources in the higher credit tranches are currently excessive and require reduction.

While the Fund's preoccupation with demand-management policies, fiscal austerity, monetary restrictions, and exchange-rate policies has not been without favorable impact on economic performance in many developing countries, conditions attached to the borrowing from the Fund have not always been discriminating, flexible, or innovative in the advocacy of economic reforms; the Fund has been inadequately aware of the inelasticity and rigidity in the price and market mechanism as well as of the institutional shortcomings in the developing countries. Most policy changes advocated by the Fund take longer to yield results than the three- to five-year period within which borrowings have to be repaid. The Fund has not demonstrated sympathetic awareness of the political constraints on economic policy making.[1] Politically, it is easier to accommodate the income-distribution effects of changes in policies and economic structure in connection with an adequate inflow of external resources, but provision of substantial external resources has been beyond the capacity of the Fund. A close coordination between the Fund and the long-term bilateral

[1] It is interesting, in this connection, to note the following statement in the Jamaica communiqué, relating to the Fund's responsibility for surveillance over exchange arrangements of the developed countries: "These principles [to be adopted by the Fund for the guidance of members in respect of exchange-rate policies] shall respect the domestic, social and political polices of members, and in applying these principles the Fund shall pay due regard to the circumstances of members." The developing countries can justifiably complain that such guidelines did not characterize the Fund's negotiations with them in regard to policy changes concerning borrowing from the Fund.

and multilateral lending institutions, to provide short- and long-term resources together, as well as recommendations of policy packages, has not always been possible.

Other Sources of Reserve Credit

The introduction in 1975 of the Extended Fund Facility to provide medium-term loans to the developing countries over a period of three years, repayable within four to eight years, signifies recognition by the Fund of the long time lag in the adjustment process in developing countries. The process involves adjustment in the structure of production and trade, as well as the mobilization and reallocation of capital and human resources, including institutional changes. Moreover, in many developing countries where cost and price maladjustments are widespread and have persisted for a long time, a sudden disinflation exacerbates the cost of adjustment. Borrowings from the Fund under this Facility are conditional upon an agreed program of long-term structural adjustment to be implemented by the borrowing country over a number of years. A liberalization of drawings from this Facility would have been an appropriate response to the recent adverse turn in external economic development that has aggravated the problems of adjustment of the developing countries.

The decisions to establish a Trust Fund out of the profits on the sale of one-sixth of the Fund's gold holdings and to liberalize the Compensatory Financing Facility are aimed at relieving the increasing balance-of-payments difficulties of the developing countries in recent years. The Trust Fund is to provide concessionary loans to developing countries with per capita income below $300. It is in a sense a replacement of (a) the Oil Facility of the Fund and (b) the UN Emergency Operations for the Most Seriously Affected Countries, both of which were discontinued in 1976. It is expected that the Trust Fund and Compensatory Financing Facility, in conjunction with the increased drawings permitted in the credit tranches, will provide about $3 billion in 1976. Yet the deficit of the developing countries is expected to be about $31 billion, out of which only $17 billion is likely to be provided by long-term loans or aid and direct investment by the developed countries. This leaves a shortfall of $11 billion to be met from other sources, including borrowing on foreign capital markets. The Jamaica Agreement does enable the Fund to repeat sales of gold holdings to help the developing countries. But if the current agreement relating to gold sales is any guide, such sales would have to be combined with the return of an equivalent amount of gold to the developed countries as a quid pro quo for helping the developing countries.

The Compensatory Financing Facility has assumed considerable importance in recent discussions as one of the components of the integrated commodity program advocated by UNCTAD, which includes the stabilization of the prices of primary commodities through international commodity agreements and buffer-stock arrangements. The Fund has increased permissible drawings under the Compensatory Financing Facility from 25 to 50 per cent of quota in a given year, and total outstanding drawings from 50 to 75 per cent of quota. It has not liberalized the conditions under which access to this Facility is available to the developing countries. The Compensatory Financing Facility is not now designed to stabilize the prices of primary exports; it compensates only partially and not automatically for shortfalls in foreign-exchange earnings, defined in relation to export earnings (calculated as a five-year average centered on the year of the shortfall), even though such shortfalls are due to circumstances beyond the control of a country. Eligibility for compensation is conditional upon the Fund's being satisfied that the country is faced with a balance-of-payments problem as a result of such shortfalls and will cooperate with the Fund in an effort to find an appropriate solution for its payments problem. Repayments are due within three to five years, whether or not exchange earnings recover to generate a surplus above normal earnings. Whether a country should receive compensatory finance and how much it should receive are not related to its need for foreign exchange to maintain its growth momentum; access is narrowly defined in relation to the balance-of-payments deficit which the country is otherwise unable to meet.

This Facility needs considerable improvement if it is to stabilize exchange earnings with a view to providing a stable flow of resources for development. In the first place, the amount of compensation should be related automatically to shortfalls in earnings; it should compensate for shortfalls in commodity exports, even though manufactured exports may not fall or may even increase; it should not be related to IMF quotas, since shortfalls are usually several times larger than the small quotas of the developing countries. Compensation in the case of the least-developing countries should be in form of grants. Repayments in other cases should be due only if and to the extent that export earnings in a subsequent year exceed the normal level of exports; if recovery in export earnings is not sufficient to repay the loan within a five-year period, the remainder should be written off.

The developing countries have been pressing in UNCTAD and elsewhere for the indexing of their export prices and earnings. While direct indexing of the prices of primary exports raises analytical and adminis-

trative problems, an element of indirect indexing can be introduced by including the effect of a change in the terms of trade in the estimation of the shortfalls in real exchange earnings. This would contribute to the stability of the income in developing countries.

In a period of declining or falling real exchange earnings, a modified compensatory financing scheme such as that suggested above would result in a net transfer of resources to the developing countries. It should be combined with a search for long-term measures, both national and international, which would reverse the decline in the real income of the developing countries by a change in production and trade. The Jamaica Agreement is conspicuously silent on the issue of the "link" between development finance and the creation of international liquidity through SDR issues. The link is admittedly a second- or third-best solution for the transfer of resources, but, in the absence of first-best solutions and with a decline in the real volume of aid, all possible avenues for increasing the flow of resources to developing countries must be explored. Both the Gold Substitution Account and the Reserve Currency Consolidation Account could be used by the IMF as vehicles for the transfer of resources in a more automatic way, freeing it at least partly from the fluctuating political will of the rich countries.

The Exchange-Rate System

The last but not least important component of the reform undertaken in Jamaica has been the legalization of floating exchange rates. The surveillance that the Fund is to exercise over the exchange policies of the members is without "teeth," except that the Fund will formulate guidelines for its members, who will supply information to the Fund and consult it about their policies when requested. The Fund, by a qualified majority, could return at a future date to a system of stable but adjustable exchange rates. In the foreseeable future, however, the degree of variability of exchange rates will basically depend upon the stability, or lack of it, of underlying economic and financial conditions, and on the extent to which national authorities intervene to moderate erratic fluctuations in exchange rates. Recent experience has demonstrated that floating exchange rates by themselves neither eliminate speculative capital movements nor reduce the requirements for reserves and accumulation of reserve-currency balances. Nor do they rule out destabilizing and excessive fluctuations in rates. (Furthermore, under floating exchange rates and with an increasing diversification of reserve-currency assets, reserve creation and destruction would depend on the decisions of central banks to

intervene in the currency market. These bear no relation to liquidity. Moreover, the decisions of central banks to change their portfolios of exchange reserves by shifting from one reserve asset to another could accentuate fluctuations in exchange rates.)

Among the many inhibitions shared in the past by developing and developed countries was the bias against fluctuating exchange rates. The developing countries, however, have been much slower to shed this bias, even though a few among them experimented with floating or frequent devaluations along with multiple exchange rates. In many a developing country, frequent exchange-rate adjustments would contribute to growth and efficiency if they could be combined with the relaxation of unnecessary and inefficient import controls. Faced with the reality of floating exchange rates and no prospect of an early return to stable rates for the major currencies, a developing country has to choose between the following alternatives: (a) pegging its currency to a key currency, i.e., the currency of its major economic partner; (b) maintaining the value of its currency in relation to a basket of currencies including the SDR; (c) adopting a freely fluctuating exchange rate. Each of these alternatives has advantages and drawbacks depending on the structure of the country's economy, its major trading partners, its size, and its degree of expertise and institutional sophistication in monetary, financial, and exchange-market management.

A small, open economy with most of its financial and currency transactions centered on a major currency would do well to peg its currency to a major currency. However, this would tend to perpetuate the present pattern of geographical specialization in its international economic relationships. A developing country with a diversified pattern of commercial and financial transactions might prefer to maintain the value of its currency in relation to a basket of currencies in proportion to their relative importance to its economy or in relation to the SDR; pegging to one major currency would deprive the country of control over the effective exchange rates of its currency vis-à-vis other currencies. Following the same logic, the foreign-exchange reserves held by such a country should preferably be composed of all the major currencies; this requires expertise and skill in the management of the foreign-exchange portfolio in order to hedge against losses. Admittedly, a greater degree of uncertainty would attach to the trade, balance-of-payments, and debt-service payments of a country that did not peg its currency to a major foreign currency, with a consequent need for more liquidity than would be required in a world of stable exchange rates.

In spite of the costs and inconvenience faced by the smaller developing

economies lacking financial expertise and institutional sophistication, floating exchange rates that enable *developed* countries to maintain relatively free trade and exchange arrangements are more advantageous in the long run for the *developing* countries than a regime of fixed exchange rates combined with restrictive trade and exchange controls. As Carlos F. Díaz-Alejandro pointed out in an Essay in this series (*Less Developed Countries and the Post-1971 International Financial System*, Essay No. 108, 1975), the latter inhibit the expansion of trade of the developing countries and restrict their access to the capital markets of the rich countries.

THE EXCHANGE-STABILITY ISSUE AT RAMBOUILLET AND JAMAICA

Charles P. Kindleberger

In what young people call the "olden days" of Bretton Woods, the British loan, the draft charter of the International Trade Organization, the Marshall Plan, Point IV, and similar programs, the executive branch of the U.S. government would go to the Congress for virtually each successive piece of legislation saying that it was the final action needed to make the system of international trade and payments function efficiently for all time. Part of the sales pitch was guileful, exaggerating the importance of the bill under consideration to persuade the Congress to pass it. Most was self-delusion. Similar self-delusion characterized administration views of the transformation of the international monetary system wrought by the adoption of Special Drawing Rights in 1968, by the initial devaluation of the dollar undertaken through the imposition of the import surtax in August 1971, and by the Smithsonian Agreement of the following December, which drew the often-quoted hyperbolic characterization by President Nixon.

Such apocalyptic views of events happily are behind us. Since the recognition by the Committee of Twenty that international monetary reform is a Darwinian process of gradual change, not a once-and-for-all act of constitution writing like that in 1789, the Rambouillet meeting of six heads of state and the Jamaica meeting of the Interim Committee of the International Monetary Fund can be seen in a soberer light. It is awkward that agreed changes in the IMF Articles of Agreement have to pass through the legislative process, since that presents the temptation again to exaggerate the coherence and permanence of the international payments system.

The fact is, of course, that the system is evolving subject to two sets of forces, long-run and short. In the long run, the reduction of costs of communication and transport has increased the efficient scale of economic operation in production, consumption, commerce, and finance and requires international harmonization of institutions in the fields of taxation, economic regulation, and the adoption of international money. The optimum economic area for many purposes is or is rapidly becoming the world. At the same time, the optimum social area remains relatively small, one in which the individual can find a sense of participation. My guess

is that in this, as in so much else, the economic forces will overwhelm the social and political—in the long run. Perhaps the optimists think the long run is five hundred years and the pessimists think it is ten to twenty. It is difficult if not impossible for individuals to feel very confident about the time profile even when they agree, as most political scientists do not, that material aspects will dominate.

The short run is even more difficult to assess. In an early draft of a paper by Fritz Machlup on the SDR, he suggested that it was called a "drawing right" to avoid the necessity to decide explicitly whether it would be an "asset," as the United States wanted and the French did not, or a "credit" to be repaid, as the French thought desirable and the United States did not. (The issue is an old one, going back to the Keynes-White debate, with the U.S. changing sides in the debate, and is inherent in the question whether the SDR is "outside" or "inside" money.) A similar papering of the cracks of disagreement through ambiguous wording emerges from Rambouillet and Jamaica on the question of stability of exchange rates. The French won recognition of the objective of stability, and the United States achieved freedom to vary exchange rates in practice when underlying instability in economic and financial factors warrants. The result is diplomatic success and economic stalemate. It is perhaps better than the confrontation between the same parties at the World Economic Conference of June-July 1933, when President Roosevelt's insistence on freedom to vary the dollar exchange rate—which in the event was used only eight months longer—produced economic stalemate and diplomatic failure.

The readiness of President Roosevelt to stabilize the dollar in February 1934, less than a year after enunciating language which suggested that the dollar would float for generations, raises an interesting possible parallel to the present. Circumstances alter cases. It may well be that the United States likes flexible exchange rates so long as the dollar is undervalued. It liked them in the spring, summer, and early fall of 1933. It likes them now. The Canadian dollar and the European snake are seriously overvalued today, as the counterpart of undervaluation of the dollar. I anticipate that when and if the European snake and/or the Canadian dollar depreciate substantially against the dollar, correcting the undervaluation through the exchange market rather than by means of a rise in prices, U.S. interest in exchange-rate flexibility will diminish rapidly. Another parallel is with the Argentine experience at the turn of the nineteenth to twentieth century, studied by John H. Williams. When world prices were falling, the Argentine authorities, responding to the meat and grain export interests, adopted flexible exchange rates and depreciation. When prices turned

up again after 1896, it proved convenient to return to the gold standard.

It is important that the United States should not become unduly sensitive—paranoid is perhaps too strong a word—to overvaluation of the dollar, in the same way that Britain is hypersensitive to unemployment and Germany to inflation. It is easy to understand the bases of these responses—Britain's in the unemployment of the 1920s following the return of the pound to par, Germany's in the inflations consequent on two world wars. Overvaluation of the dollar in 1931-33 and again in some part or all of the 1960s and the 1970s could easily generate another conditioned response dysfunctional for the international monetary system in a measure comparable to those of Britain and Germany.

One or two words about these overvaluations may not be amiss. In 1931-33, the dollar was overvalued despite the current-account surplus, which led many observers at the time to interpret the 1933 depreciation as a beggar-thy-neighbor act. An overvaluation that fosters a deflation that picks up dynamically at such a rate that it produces an export surplus is still an overvaluation. In this instance, the condition of the current account is misleading. On the other hand, I find it hard to accept the view of many contemporary observers, including my colleague Paul Samuelson, that the dollar was overvalued all through the 1960s, beginning as early perhaps as the stabilization of currencies in 1958. The surplus on goods-and-services account was more than $8 billion in 1964, and while there was a liquidity deficit of the order of $3 billion that year, as in a number of years earlier and afterward, this seems to me to be the amount of international financial intermediation—lending long and borrowing short—sought by the world to satisfy its liquidity needs.

The dollar was clearly overvalued by 1971. The trouble had set in in about 1968, with inflation from the Vietnam War and the curious loss of competitiveness which seemed to emerge suddenly in the industrial sector. More research is needed on this issue, theoretical and empirical, with the theoretical consisting in establishing a criterion for under- or overvaluation in the case of a country which served as an international banking center. No one had much doubt that the dollar was undervalued in July 1973. My hunch is that it is considerably undervalued now, especially against Canada, which has been running a deficit with the United States that represented nearly half the total U.S. current-account surplus in 1975.

If Rambouillet and Jamaica represented a clear-cut victory neither for the French nor for the United States, it is still correct to regard them as another step—though perhaps an unimportant one—on the winding and bumpy road to greater exchange-rate stability. They are unimportant because they do not change events so much as recognize them. Moreover,

the focus of action is elsewhere, particularly on the decisions of separate countries to stabilize their currencies for one or another reason, all of which, in my judgment, add up to restoring in some degree the benefits of money as a public good in the international sphere. Particularly significant are the decisions of Sweden and Switzerland to join the European snake. (The French decision to rejoin the snake, recently reversed, may have had a large political component.) The Swiss decision is based on the danger that overvaluation of the Swiss franc in consequence of heavy capital inflow will damage still further the export sector, already hurt by the innovation of the electronic watch, in which Swiss industry has a minimal share. The Swedish case is especially interesting, since exchange stability can be defined in terms of a weighted average of currencies or of a single partner currency. The Swedish decision to fix on the European snake comes close to a decision to stabilize in terms of the German mark. Stabilization in this manner by an economically sophisticated country with experience in floating raises anew the questions of the costs and benefits of an international money, a question which will occupy research students for some time to come.

At the moment, the debate is not at a very lofty level. Harry G. Johnson, for example, has twice predicted that the world is returning to fixed exchange rates but for reasons which he holds to be misguided. His prediction in June 1975, in *Weltwirtschaftliches Archiv*, seems to be based on the alleged stupidity of government authorities, including central bankers, an attribute shared by Canada as a whole. It seems curious that a school of thought which believes that markets are rational and the businessman is always right should think that governmental authorities are universally wrong. In a second article, in the *Three Banks Review* for September 1975, Johnson initially suggests that restoration of fixed exchange rates in the near future is "extremely unlikely" and defends floating, or, rather, attacks the "so-called economists" who see merit in fixed rates and the "superficial thinking and logic that one has learned to associate with the mental processes of those who have an emotional commitment to fixed exchange rates." He nevertheless predicts that when a change to greater and more sustained stability in prices and employment occurs, "there is likely to be some sort of international co-operative attempt to return to a fixed exchange rate system of some kind." This is for two reasons: (a) the costs of changing to fixed rates will appear negligible by comparison with the benefits of a closer approximation to a single world money, and (b) there are important vested interests for the financial community—business convenience and a nondemocratic veto over elected government—and for the Treasury, which can foist the burden of its mistakes onto foreigners through the fixed-exchange-rate system.

What shines through Johnson's language is that he dislikes fixed rates intellectually but thinks they are coming. He cannot make up his mind whether to find reasons to justify what he anticipates will happen, as if by revealed preferences and efficient, rational processes, or to take the view that the world is governed by irrationality. When a strong advocate like Johnson predicts that a closer approximation to fixed rates is on the way, however, it makes news. We expect such statements and receive them from the recently retired and new Presidents of the Federal Reserve Bank of New York, though the emphasis of Alfred Hayes on Darwinian evolution in his Per Jacobson Lecture of August 1975 is noteworthy. But when the Archbishop of Canterbury (Johnson) says that God (flexible exchange rates) does not exist (will not persist), that's news.

Rambouillet was a political rather than an economic exercise. The significance of Jamaica, by contrast, lay outside the issue of fixed-*vs.*-flexible rates and much more in the questions of the debts of developing countries, their continued deficits as they seek to pay for oil, and how debts and deficits can be financed. In this respect, Jamaica was only one of a series of meetings, including those of UNCTAD in Manila in February 1976 and in Nairobi in May 1976. Important work is being done on this problem by staff members of the International Bank for Reconstruction and Development. They provide the statistics on borrowing by low- and middle-income non–oil-producing countries, now more than $100 billion, giving rise to debt service estimated at $7 to $10 billion a year. How supplier credits, loans from private banks, differing credit facilities managed by the IMF, and soft and hard loans from the IBRD will be handled in case of a crunch is a delicate and difficult topic that the Interim Committee of the IMF pushed forward at Jamaica. But there is a much longer road to be traveled. The old days from 1819 to 1914, when the Bank of England was lender of last resort, are over, as are the younger days from 1945 to 1963 (or 1968 or 1971), when various U.S. agencies fulfilled the role. In the world of 1976, should there be one lender of last resort, two, three, more? And how should it (they) operate? On the exchange-rate front, Rambouillet and Jamaica made a little progress along an evolutionary path where time is not important. The pressing task of international payments at Jamaica was to build levees against flood waters from rivers that are not very high and may not overflow present banks. But most rational men believe in insurance, especially when the costs are still low, and it is better to be safe than sorry.

BETWEEN OUTLINE AND OUTCOME THE REFORM WAS LOST

Fritz Machlup

For years, monetary experts had been discussing the basic faults of the international monetary system and searching for the essential changes needed to reform it. The international groups, committees, and boards charged with the task of designing the reform had issued statements, reports, and outlines based on serious study, frank discussion, and near agreement. Apparently, they had agreed on the principles to be followed, and they spelled them out in June 1974 in an *Outline of Reform.* In January 1976 in Jamaica, the governments reached an agreement "bringing to completion" (as one of the announcements said) the preparatory reform work and "setting the full stop after year-long labor" (as one of the participants said). Unfortunately, only empty phrases from the *Outline* were preserved in the final accord; the important principles were lost in the shuffle, or deliberately dropped.

The Basic Faults

What were the basic faults of the Bretton Woods system? Before answering this question, one ought to distinguish between the system as its designers *meant* it to function and the system that actually *developed* as a result of the practices of the monetary authorities of the member countries. Furthermore, the visions and anticipation of the designers were not uniform; what John Maynard Keynes had in mind was not the same as what Harry White thought about the way a good system should work and how the provisions of the International Monetary Fund would affect the countries' monetary policies. Thus, criticism or defense of the "Bretton Woods system" is often pointless. Nevertheless, the visions of the architects of the system, the implications of the stated provisions, and the actual operation of the system can be subjected to one fundamental charge: the system lacked an adjustment mechanism and failed to provide for an effective control of international reserves.

The absence of an adjustment mechanism and the failure to control international liquidity are so closely related that they can be seen as two aspects of the same problem. The purpose of control over international liquidity—both the total of liquid reserves and the way they are distributed among the countries—is to ensure that the members cannot unduly postpone taking measures to initiate a process of real adjustment. Such

adjustment can be achieved by altering effective demand in the countries in imbalance and/or the exchange rates of their currencies. Reserves serve to enable countries in deficit to finance imbalances and defer adjustment. Indeed, it was the chief purpose of the Fund to provide additional liquidity to countries in deficit and, by helping them finance presumably temporary deficits, *avoid harmful restrictions* on trade and payments and *painful adjustments* of effective demand and/or exchange rates.

No matter whether adjustment and liquidity are seen as two problems or as two aspects of the same problem, the experts recognized rather early in the discussions that these were the key issues and that any real reform had to provide for a reliable adjustment mechanism and for controlled growth of total monetary reserves.

Agreement on these key issues among *academic* economists goes back many years. The literature on the subject is so well known that it is not necessary to provide references. It may, however, be appropriate to refer to the "Report on the Deliberations of an International Study Group of 32 Economists," published under the title *International Monetary Arrangements: The Problem of Choice* (Princeton, International Finance Section, 1964). This Report presented the problems of the Bretton Woods system and its possible alterations or alternatives with so much foresight that a rereading of this document after twelve years may be rewarding. More significant in the present context, however, is the fact that also the *official* specialists of the treasury departments and central banks, the nations' delegates to the committees charged with formulating the principles of reform, have agreed on the fundamental needs of a workable system. Their statements, released over a period of eleven years, emphasized the importance of building into the reformed system an effective adjustment mechanism and international control and management of international liquidity.

The Outline of Reform

These objectives were still prominently displayed in the *Outline of Reform* released by the Committee of Twenty on June 14, 1974. They were conspicuously absent from the Jamaica Agreement of January 8, 1976, except for some empty phrases regarding further "evolution" in future years. The two main principles of reform got lost or were dropped in the course of diplomatic negotiations in 1975, chiefly between France and the United States, after other countries, tired of the "ideological" conflict between these protagonists, decided to leave it to the two champions of extreme positions to come to an agreement.

How were the adjustment and liquidity problems to be solved according to the *Outline of Reform*? According to Part I, Section 2:

> The main features of the international monetary reform will include:
> (a) an effective and symmetrical adjustment process, including better functioning of the exchange rate mechanism, with the exchange rate regime based on stable but adjustable par values and with floating rates recognized as providing a useful technique in particular situations; . . .
> (d) better international management of global liquidity with the SDR becoming the principal reserve asset and the role of gold and of reserve currencies being reduced.

Regarding "Adjustment," the *Outline*, in Section 4, provided:

> [To] assure timely and effective balance of payments adjustment,
> (a) Countries will take such prompt and adequate adjustment action, domestic or external, as may be needed to avoid protracted imbalances . . . ;

and

> (b) Countries will aim to keep their official reserves within limits which will be internationally agreed from time to time in the Fund and which will be consistent with the volume of global liquidity. For this purpose reserve indicators will be established. . . .

To enforce adequate actions, countries would, according to Section 6, "become subject to examination" by a consultative body if either "(a) there has been a disproportionate movement in its official reserves; or (b) in the judgment of the Managing Director . . . there is prima facie evidence that a country is facing significant imbalance. . . ."

Moreover, according to Section 10, if the assessment by the Executive Board fails to "lead to appropriate adjustment action," the Fund "will have available graduated pressures to be applied to countries in large and persistent imbalance, whether surplus or deficit."

Regarding the "Exchange Rate Mechanism," the *Outline* provided in Section 11 that "countries should, whether in surplus or deficit, make appropriate par value changes promptly," and in Section 13 that "countries may adopt floating rates in particular situations, subject to Fund authorization, surveillance, and review."

Finally, with regard to official reserves, the *Outline* provided in Section 24:

> The SDR will become the principal reserve asset and the role of gold and of reserve currencies will be reduced. The SDR will also be the numeraire in terms of which par values will be expressed . . . ;

and in Section 25:

> As part of the better international management of global liquidity, the Fund will allocate and cancel SDRs so as to ensure that the volume of global reserves is adequate and is consistent with the proper functioning of the adjustment and settlement system.

The Jamaica Agreement

What, of all these well-considered provisions, has been retained in the Jamaica Agreement? Almost nothing. Of course, the agreed amendments to the Articles of the Fund will include the permissibility of floating exchange rates—so that the Fund members need not go on living in sin. That the floating will go on is not questioned: it should be clear to anybody in his senses that under present conditions the world has no other choice. Floating is now the only system that can work without continuously recurrent crises in the exchange markets, and all talk about an early return to a system of fixed par values is just for the birds—for the consolation of traditionalists sick with nostalgia and for the reassurance of exporters weak in the art of multiplication.

To be sure, wildly roller-coasting exchange rates are too disconcerting for all but the bravest souls; hence, managed flexibility is preferred and, even to the purist, quite acceptable, provided the managers do not resist movements dictated by market forces that push in a definite direction for more than a few weeks. But since interventions in exchange markets may lead to mischievous cross-rates if the intervening central banks are not in daily communication with one another, arrangements for concerted interventions are desirable. (This was explained in the 1964 Report of the 32 Economists.) The Jamaica Agreement provided for this accommodation. The Ministers and Governors of the Group of Ten, in their meeting of December 1975, had given their approval to the proposals (agreed between the United States and France) to "intensify" consultation procedures on exchange-rate movements, and they noted that their central banks were in the process of "deepening and broadening" their consultations. One can only hope that this accommodation will not be misused for the purpose of keeping misaligned exchange rates from getting adjusted.

What about the adjustment mechanism? The Press Communiqué of January 8, 1976, contains not a word about it.

What about the control of official reserves? There is a reference to it as follows:

> The amended Articles of Agreement should include a provision by which the members of the Fund would undertake to collaborate with the Fund and with other members in order to ensure that their policies with respect to reserve assets would be consistent with the objective of promoting better international surveillance of international liquidity and making the special drawing right the principal reserve assets in the international monetary system.

This sounds all right but is in fact only an empty phrase. In order to institute effective control (not merely surveillance) of liquidity, the provision would need "teeth," such as real commitments by the members regarding changes in their reserves and pressures upon members who do not live up to these commitments. None of this was retained in the Jamaica Agreement.

What about the substitution of SDRs for existing currency reserves and gold, the consolidation of these reserve assets "at the outset of the reform"? (The *First Outline of Reform*, of October 1973, had used this phrase.) Nothing of this sort has become part of the Jamaica Agreement, except for lip service to the idea in the form of an exhortation that "the Executive Directors should continue their consideration of the subject of a substitution account," and this weak provision was diluted by an injunction that the work should be done "without delaying the completion of the Comprehensive Draft Amendment." The alleged objective of making the SDR the "principal reserve asset" is shown to be a sham by the absence of any attempt to reduce the role of foreign-exchange reserves and by the main features of the new agreement about gold—to allow an increase in the physical amounts of gold in the members' official reserves, to allow increases in the book value of gold held by the monetary authorities, and to enhance the liquidity of gold reserves by making them more usable in official transactions.

The Arrangements for Gold

It was agreed "to start without delay the simultaneous implementation of the arrangements" made by the Interim Committee on August 31, 1975. These arrangements were, in my own (perhaps more transparent) exposition, as follows:

a. The old "official price" of gold ($42.22 per ounce), the fictitious value at which gold reserves have been carried on the books and balance sheets of the monetary authorities, is to be abolished.

b. One-sixth of the gold now held by the International Monetary Fund is to be sold through a trust fund "for the benefit of developing countries," the profit (excess of selling price over the old book value) to be distributed among these countries.

c. Another sixth of the gold now held by the IMF is to be returned to the member countries of the Fund.

d. The rest of the Fund's gold is to be held by the Fund until its disposition is determined later by an 85 per cent majority of the total voting power.

e. There shall be no action to peg the price of gold—at least not in the next two years.

f. The total stock of gold now in the hands of the Fund and the monetary authorities of the Group of Ten shall not be increased—at least not in the next two years.

g. Each party to these arrangements will report semi-annually the total amount of gold that has been bought or sold.

h. All these arrangements will be reviewed in two years, and any party may terminate adherence to them after the initial two-year period.

i. In line with an earlier decision, national monetary authorities are free to enter into gold transactions with one another in which gold may be valued at market-related prices.

These arrangements have the following implications:

Re a. National monetary authorities may, if they wish, write up their gold reserves to the market value. If their gold reserves are now (December 1975) stated at the old book value ($42.22 per ounce) and were written up to the recent average price at which gold has been traded in the free markets ($132.00 per ounce), the gold reserves would be increased from $41.6 billion to $130.1 billion.

Re b. If the 25 million ounces of gold that are to be sold for the benefit of developing countries were offered to the market in a few big lots within a year or two, while none of the national monetary authorities or international agencies were buying from the market, the price of gold might fall to the level of the old official price, or even lower, and there would be no profit to distribute to poor countries. On the other hand, if national monetary authorities or international agencies were allowed to buy gold in the market, official gold reserves would be increased further by this new "monetization" of gold. (The Jamaica Agreement states "that the Bank for International Settlements would be able to bid" in the gold auctions of the Fund.)

Re c. If the monetary authorities to which another 25 million ounces are to be returned have to pay only the old official price of $42.22 per ounce for this gold—hence, about $1.1 billion—they will receive an addition of $3.3 billion (at the market value) to their gold reserves, and make a net profit of about $2.2 billion. How they will pay the $1.1 billion to the Fund —in dollars or in their own currencies (which would cost them nothing at all) has not been announced.

Re d. The remaining 100 million ounces of gold in the possession of the Fund will stay with the Fund until further decisions are made. But it should be borne in mind that the disposal of the 50 million ounces, if they go—whether directly or indirectly, entirely or partially—to the national monetary authorities, constitutes the exact opposite of what most experts had recommended. For more than ten years they have advocated central pooling or consolidation of all monetary gold reserves; the new arrange-

ments provide for a distribution or deconsolidation of monetary gold previously pooled.

Re e. The agreement not to peg the price of gold is practically meaningless, first, because it holds for only two years and, second, because support purchases of gold will not be called pegging if the price is not fixed at a pre-announced level. If the price of gold in the market tends to fall and one or more central banks or other national (or international) agencies enter the market as bidders and buyers, they can easily succeed in keeping the price from falling below what they might regard as a reasonable level. Moreover, if monetary authorities announce the prices at which they deal in gold with one another—as they may under the provision stated in (i)—they will influence the speculative buyers and holders of nonmonetary gold.

Re f. That the total gold holdings of the Fund and the countries of the Group of Ten will not be allowed to increase in the next two years may prevent concerted efforts to drive up the price of gold or to support it when the market is especially weak; but the rule may still allow effective price support through official purchases when other official holders decide to sell some of their gold.

Re g. The requirement to report official sales and purchases of gold every six months is typical of the disrespect for the principle of cooperation through effective leadership of the IMF and for the principle of surveillance as well. One would think that an international monetary authority ought to be kept informed of every action that may affect "global liquidity." Monthly reports ought to be considered the minimum requirement, and weekly reports would not have been too frequent. The arrangement for semi-annual reporting reflects the national resistance to supranational guidance and prerogatives.

Re h. The limitation of all the agreed arrangements to a period of only two years is a further demonstration of the countries' unwillingness to be bound by international rules of the game.

Re i. The freedom of the national authorities to engage in gold transactions with one another at market-related prices gives to gold a degree of liquidity which it had lost when official purchases at prices exceeding the official level (far below the market price) were prohibited. Many experts claim that the great risk implied by a fluctuating market price will prevent central banks from buying gold even from other official sellers. This would be true if all central banks acted alone rather than in concert; it is hard to believe that they would abstain from forming coalitions designed to give their largest reserve asset a degree of stability that effectively reduced the risk of holding it. To form such a coalition would be difficult if dozens of institutions were needed for its operation; but it would be quite easy for five or six of the gold-holding central banks to get together in "fixing" (by gentlemen's agreements) the range within which they would allow the price of gold to fluctuate. Such a cartel of national monetary authorities would achieve what rule (e) tries to avoid.

Summarizing the implications of the arrangements—which are claimed to be "appropriate" to the announced intention to reduce the monetary role of gold—we must conclude that they are apt to achieve exactly the opposite objective: to enhance the role of gold.

The SDR, the Supposed Principal Reserve Asset

The increase in the monetary role of gold implies a decrease in the role of the SDR. This reserve asset, still supposed to become the "principal" reserve asset of the reformed system, actually becomes a tiny, almost negligible, part of total monetary reserves.

In January 1970, when the first SDRs were issued, the $3 billion worth represented 4.3 per cent of total reserves; a year later, when the second allocation doubled the amount issued, the relative share rose to 7.5 per cent; in January 1972, with the third and last allocation, SDRs still represented only 7.3 per cent, because by then foreign-exchange reserves had much increased. By December 1975, after further accumulations of exchange reserves, the proportion of SDRs in total reserves had fallen to 4.8 per cent. With a write-up of gold reserves to a market price of $132 per ounce, the proportion of SDRs in total reserves would be reduced to 3.4 per cent, less than on the day of the first allocation. Exchange reserves of almost $160 billion and gold reserves potentially valued at almost $130 billion, or even $137 billion after the Fund disposes of the first third of its gold, would dwarf the $11 billion worth of SDRs now in existence.

The Communiqué of the Interim Committee, announcing the proposed arrangements on August 31, 1975, repeated the resolution "to ensure that the role of gold in the international monetary system would be gradually reduced." This reference to "gradual" reduction in the monetary role of gold cannot possibly relate to the fact that gold is no longer the common denominator for fixed par values of currencies. This role lapsed automatically when the par-value system was abandoned. Nor did the SDR become the "principal reserve asset" when it was made the reference point for expressing the relative values of currencies in the foreign-exchange markets. Neither a reserve asset nor any asset is needed for this purpose:

the number system, taught in elementary arithmetic, suffices. Any number, say the number 1, can be the common denominator. Expressing relative currency values in terms of SDRs does not affect the status of the SDR as a reserve asset and surely does not make it "the principal reserve asset," as had been agreed in 1973 and 1974.

The only sound way to make the SDR the principal reserve asset is to give it the role of determining the gradual increase in global liquidity and of ensuring an improved adjustment mechanism. That this is practically impossible if SDRs are such a small part of total reserves seems clear. The language used in the Communiqué of the Interim Committee is rather deceptive on this issue. When the Interim Committee recites its earlier "general undertaking" to "ensure that the role of gold in the international monetary system would be gradually reduced," one must wonder whether the parties to such an agreement are trying to deceive themselves or the public.

SOME QUESTIONS REMAINING

Robert V. Roosa

The most significant and promising result of the negotiations culminating in Jamaica is the seemingly genuine consensus that floating should be legitimized, and also that central banks should jointly manage the amplitude of fluctuations as exchange rates respond to changes in basic economic relationships among countries. It is equally encouraging that the Interim Committee agreed to increase IMF quotas by nearly one-third and approved an accompanying pledge that each member country will henceforth permit its own currency to be used, at least by the IMF.

Although the details of these and other agreements had not yet been completed by the IMF Executive Directors as these words were written, their articulation will probably not resolve a number of still perplexing unknowns. Among them are these:

Will the various decisions concerning gold lead to more, or less, monetary stability among nations?

Do the decisions at Jamaica, taken as a whole, support the repeated pledges made there to center the international monetary system on SDRs as the world's principal reserve asset?

Will the undertaking by each country to maintain domestic stability as a basis for international monetary stability be consistent with, or permit, symmetrical patterns of adjustment among countries, among those expanding and those contracting, among those inflating and those deflating? For example, is the structure emerging from Jamaica likely to cause countries deliberately to accelerate or to slow their own domestic expansion in order to maintain or restore balance in their payments flows with each other, or to maintain stability in their exchange-rate relationships, or both?

Will the combination of additional compensatory financing with enlarged IMF quotas and the new Trust Fund be able to provide adequate "bridging finance" for the balance-of-payments needs of the developing countries? Or is there a risk that the "new" system at times may only generate more constrictive pressure upon some of them? Or may additional actions be needed in the real sector, over and above these monetary facilities, to improve the prospects of most developing countries for stability and growth?

The answers to these questions are still cloudy.

The Role of Gold

Perhaps the protestations at Jamaica and earlier that gold must be "removed from the system" mean different things to different people. Some countries apparently expect that gold will indeed soon disappear from national monetary reserves and become purely a marketable commodity—just another nonferrous metal, though a precious one. Most countries, however, seem to regard that as quixotic, or at least unnecessarily doctrinaire, and are instead content with elimination of the official gold price, abandonment of any obligation to pay gold to the IMF, and agreement to permit the sale of some IMF gold to original contributors and to the markets.

But several countries seem to be lying in wait for the end of the two-year period of limited abstinence agreed to by the Group of Ten countries (a period ending in August 1977 or January 1978) in order to begin adding further to official gold reserves. Such net purchases, if and when they are undertaken by a few countries, need not necessarily pose a challenge to the agreed general aim of ensuring "that the role of gold in the international monetary system would be gradually reduced," as promised in the Interim Committee Communiqué of August 31, 1975 (Par. 6). But subtle pressure will surely begin building soon for a common effort to recognize and use gold as a significant part of monetary reserves, and for central-bank action to place a minimum gold price under the market.

Two other consequences may ensue. (a) Some countries that still hold sizable gold stocks, encouraged by others who have been acquiring more, may be persuaded to join together in a gold bloc. (b) The IMF, intimidated by the risk of precipitating a drop in the gold price if it becomes an active seller, may decide to give up the contemplated sale of 25 million ounces of gold in the market. Neither of these potential consequences can be expected to promote the worldwide stability and harmony in monetary relations that was sought at Jamaica.

There may yet be an escape from either of those outcomes, however, provided gold is explicitly given a reduced but still meaningful role in a world that will probably never quite believe that gold can be banished altogether from monetary arrangements. That would be to elevate and diversify the use of gold as collateral in transactions among central banks, and between the IMF and central banks. If used to support loans (or in repurchase agreements)—at notional prices agreed upon for each transaction and with adequate allowance for margin and provision for margin calls—the gold reserves of the central banks now holding them would be unfrozen.

Such transactions would not seriously endanger the market price of gold, but they would reduce the motive for central banks to support the market price; and they would enable the IMF to acquire through market sales, or even through long-term "repurchase agreements," substantial amounts of the usable currencies intended for the Trust Fund that is to assist developing countries that have per capita incomes under $300 per year. This is no panacea, but in a world where confidence is at the heart of any monetary system, some compromise with the human urge to place some dependence on gold may be preferable to doctrinaire insistence on total abandonment.

The Role of SDRs

Just as the assurances that "gold must go" may prove to be an overstatement, there is an equally likely potential for disappointment in the agreement that the SDR must be made "the principal reserve asset in the international monetary system," as promised in the Interim Committee Communiqué of January 8, 1976 [Par. 7(a)]. The hard question is whether there will be occasion over the next decade to create sufficient SDRs to make them a meaningful part of the reserves actually held by central banks. Perhaps the operational implications of Jamaica point instead toward relegation of the SDR to the role of numeraire for IMF transactions and of index-number base for some international bodies. Or, as mentioned again below, the gaps still left in facilities for aiding the developing countries may encourage creation of new SDRs as a means of extending "costless" credits to needy countries—thereby linking pressures for SDR creation with the granting of aid. But any deviation from reliance on a measured judgment of the needs for international liquidity to control the supply of SDRs would destroy their credibility as a reserve asset.

Perhaps prospects for the SDR as a usable reserve asset will depend on the pace at which progress is made by some countries toward restoration of par values for their currencies. The procedures for moving in that direction, under the aegis of the IMF, have been defined in the proposed Article IV, which contemplates ultimately a mixed system in which countries may choose either to float or to accept the obligations and constraints of maintaining currencies at par values set by agreement with the IMF. Indeed, if the stage is reached when the par-value provisions (Schedule K) of the new Article IV are activated, there is an explicit prohibition against the re-insertion of gold or a reserve currency as the official reserve asset, presumably establishing a primary role for the SDR in reserve settlements among central banks.

The Adjustment Process

But the journey back to par values will probably be long, if not endless. Consequently, reliance will have to be placed essentially on the strengthening of arrangements for consultation and surveillance agreed to at Rambouillet and Jamaica if there is to be a restored facsimile of the more useful aspects of international discipline that were inherent in the Bretton Woods system. If there is to be reasonable stability in monetary relations, while at the same time the system is to be free of the distortions produced by overlong adherence to unrealistic exchange rates, there will have to be a "case history" development of guidelines and criteria for use by the central banks who join in "multilateral surveillance." The progress at Jamaica in this direction consisted almost entirely of improving facilities for more frequent and wide-reaching consultation among central banks and with the IMF. The evolution of actual working norms, on which the emergence of a workable combination of flexibility with restraint must depend, still lies ahead.

During the recent bout of frightening inflation, nation after nation has rediscovered (along with New York City) that there is no substitute for invoking the scapegoat of balance-of-payments losses and the conditions of creditworthiness specified by potential creditors when national leaders set out to take needed measures of internal restraint and realignment in the face of contentious domestic resistance. It is interesting, but also disappointing, that after years of negotiation in various international bodies over "rules of the game" for the adjustment process, the negotiations at Jamaica sidestepped those issues by placing present hopes on refurbished procedures rather than reinforced principles.

The Developing Countries

The Jamaica Agreement, by initiating an enlargement of IMF quotas, and by adopting interim procedures to balloon present quotas over the one to two years needed for completing the formalities of regular quota increases, has added importantly to the IMF's ability to meet balance-of-payments strains of particular countries. It supplements the expansion of the IMF's compensatory financing arrangements, which the Executive Board approved shortly before the Jamaica meetings in order to provide additional relatively automatic financing of balance-of-payments shortfalls related to crop or production failures or to abrupt declines in world commodities prices. The new quotas have, of course, enlarged facilities for meeting longer-lasting balance-of-payments difficulties occurring in any member country.

By retaining the "tranche system," both in the regular quotas and in the temporary balloon, the Jamaica negotiators have kept to the principle of intensifying pressure as countries reach into the third and fourth tranches of their drawing rights. To the extent that less developed countries encounter balance-of-payments difficulties that are susceptible to correction through traditional methods of domestic restraint, this continuation of IMF discipline is understandable and appropriate. But the quota arrangements, together with the added facilities for compensating temporary shortfalls, do not exhaust the list of LDC problems.

There was recognition that the deteriorating position of many of the developing countries—accentuated by the steep rise in oil prices and the decline in real production in much of the world—called for even more supplemental assistance, probably for longer periods and on easier terms than are normally provided by the IMF. That is why a Trust Fund was established, to be financed from the proceeds of the sale of 25 million ounces of IMF gold. The resources of this Trust Fund, to be used only for the poorest among the developing countries, are to be made available on such generous terms, however, as to move the IMF dangerously close to the zone reserved for the IBRD and its family of institutions. In that sense, the Trust Fund (if enough gold should ever be sold to make it actually operational) may tear a gaping hole in the fabric of the institution that is supposed to assure the integrity of the world's monetary system.

Any measures tending to convert the IMF into an agency for aid on an extended basis, as distinct from the transitional financing of balance-of-payments swings, will weaken the already fragile confidence on which the effectiveness of this or any central monetary institution must depend. To be sure, a Trust Fund created from gold sales need not yet threaten confidence. The risk ahead is that an impatience for results, while the gold sales are proceeding only sluggishly, if at all, will lead toward the fateful use of the IMF's money-creating capability to meet urgent needs for aid to the developing countries. It is regrettable that the parallel meetings at Jamaica directed toward enlarged resources for the IBRD group could not have found room for these added emergency facilities in order to assure that transfers of real resources for the assistance of less developed countries would occur through established IBRD procedures. These facilities involve raising capital from governments or within the capital markets of the world, an alternative devoutly to be preferred to the perversion of the IMF's monetary integrity.

There is no doubt that the Rambouillet-Jamaica agreements move the

international monetary system forward. But the gains come mainly in legitimizing the removal of past rigidities as a result of which needed monetary disciplines became transposed into aggravating causes of economic crisis or contraction. There is still much to be done, in the evolutionary process that has been fermenting over the past decade and more, to establish a secure basis for monetary stability in a growing world.

JAMAICA: "MAJOR REVISION" OR FIASCO?

Robert Triffin

I wish I could join, with sincere conviction and a good conscience, the official chorus of congratulations and self-congratulations about the Jamaica achievements, but I cannot. I do not honestly think, as Secretary Simon apparently does, that Jamaica is comparable to Bretton Woods. Even less can I see in it, with Minister Fourcade, "the beginning of a new monetary and political era."

Such comments only call back to my mind—and maybe to those of some of my readers—President Nixon's glowing characterization of the 1971 Smithsonian Agreement as "the most significant monetary agreement in world history."

The Earlier Consensus

Can the Jamaica Agreement really be accepted as the final outcome of more than twelve years of nearly continuous official debates and negotiations on international monetary reform? The question is worth asking, since it embodies a 180-degree turnabout in relation to the main analysis and conclusions that had emerged in previous discussions.

The highlights of the postwar evolution of the international monetary system can be summarized in two sentences. The system conferred an increasingly overwhelming role to the U.S. dollar, *de facto* and even partly *de jure*, as the effective numeraire for exchange rates, the major instrument for international settlements and central-bank interventions in the exchange markets, and the main component of private working balances as well as of the growth of official reserves. The dependence of reserve growth on the piling up of U.S. debts to foreign central banks inevitably and predictably led to the collapse of the gold convertibility of the dollar as the gold-convertible debt of the United States to foreign monetary authorities rose to a multiple of the U.S. gold stock and its other reserve assets.

The functioning of the system revealed four basic shortcomings, calling for fundamental reform:

1. The inflationary explosion of world reserves under the impact of U.S. deficits, after 1969. World reserves increased as much over the three years 1970-72 as they had in all previous years and centuries. Who can doubt that this had something to do with the outbreak of one of the worst world

inflations in man's history and contributed to the later explosion of oil prices?

2. The frustration of the famed balance-of-payments mechanism of adjustment for the reserve-center country, which was enabled by the system to finance its deficits with its own IOUs. The overall deficits of the United States could not have totaled about SDR 66 billion over the five years 1970-74 if 93 per cent of them had not been financed by other countries' acceptance of U.S. IOUs as international reserves. The adoption of floating rates was a desperate attempt by each surplus country acting independently to stem this inflationary flood.

3. The earmarking of reserve growth for the financing of the richest and most capitalized countries, irrespective of their policies, rather than for the financing of internationally agreed objectives, such as—among others—economic development of the poorest and most undercapitalized countries. Of the SDR 100 billion growth of world reserves over the five years 1970-74, about 97 per cent was invested in the developed countries—mostly the United States—and only 3 per cent in the less developed countries. These reserve investments in the richest countries were about triple the total amount of recorded official assistance by the OECD countries to the developing countries.

4. Finally, the instability inherent in the system, leading to growing movements of speculative capital and frustrating national monetary management in the recipient as well as the losing countries.

This analysis of the shortcomings of the system had led to a large intellectual consensus concerning the measures deemed most essential to its reform. These were summarized in the last report of the Committee of Twenty as consistent arrangements for (1) an effective and symmetrical adjustment process, (2) an appropriate form of convertibility with symmetrical obligations on all countries, (3) a better management of global liquidity, with the SDR becoming the principal reserve asset, (4) cooperation in dealing with disequilibrating capital flows, and (5) the promotion of the net flow of real resources to developing countries, including possibly a "link" between development assistance and SDR allocations (excerpted from "Outline of Reform," June 14, 1974, pp. 8, 17-18, and 45 in *International Monetary Reform: Documents of the Committee of Twenty*, IMF, Washington, D.C., 1974).

Changing Course

The "major revision" of the Articles of Agreement of the International Monetary Fund promised in Jamaica obviously bears little relation to the reforms outlined by the Committee of Twenty.

The point on which the most concrete action has already been taken or is announced is the enlargement of resources—concessionary and other—to be made available to the hard-pressed developing countries and particularly the poorest of them. This undoubtedly helped rally LDC agreement to the Press Communiqué of January 8, 1976, in spite of the absence of any reference to the famous "link" proposal. The link will remain academic anyway as long as the flooding of world reserves by reserve currencies and by the *de facto* revaluation of gold removes any justification for new SDR allocations for a long time to come. A bird in the hand was deemed better than two—or even more—birds in the bush or the air.

The agreements on gold admittedly go in the direction anticipated in former negotiations and hammer out ingenious compromises between opposite viewpoints and interests, as far as the partial liquidation of IMF gold holdings is concerned. But they certainly do not even begin to solve in a rational way the major problems raised by the far larger gold holdings of the national monetary authorities—their ultimate disposal or retention as part of the international reserve and settlement system, and the inflationary implications of a sudden revaluation of current holdings to, or close to, current market prices. The Communiqué bears little or no trace of the various suggestions made to meet these inescapable problems.

The other major breakthrough announced in Jamaica is the agreement on exchange rates embodied in the proposed new Article IV on "Obligations Regarding Exchange Arrangements." Frankly, I find this text more worthy of a slapstick comedy than of a solemn treaty defining a new international monetary system. The only obligations I can find in it are the "General Obligations of Members" spelled out in Section 1 and invoked repeatedly in the other four Sections. They are so general and obvious as to appear largely superfluous. Which country would not wish to foster orderly economic growth and financial conditions, together with reasonable price stability and a monetary system that does not tend to produce erratic disruptions? Which would not want to avoid manipulating exchange rates "in order to prevent" effective balance-of-payments adjustment? Let us admit that some countries may have failed in these endeavors in the past and occasionally tried to gain an unfair competitive advantage over others. But how does this Article propose to change this and to remedy the shortcomings of the previous monetary system that tolerated—or even fostered—the total frustration of these high objectives in recent years?

Three different types of exchange arrangements are spelled out in the remainder of Article IV. The first is "an international monetary system of the kind prevailing on January 1, 1976." The second and the third could

be adopted by an 85 per cent vote of the Fund and *either* "make provision for general exchange arrangements" *or* "determine . . . that . . . conditions permit the introduction of a widespread system of exchange arrangements based on stable but adjustable par values."

What is most striking, however, is that all three of these systems have one common feature. It is that each country can, in any case, use whatever system it wishes—pegging its rate to any denominator whatsoever (such as a foreign currency, the SDR, or any other package of currencies) except gold, or having any "exchange arrangements of their choice." Not even an 85 per cent majority can modify that right, unless a member has been foolish enough to commit itself voluntarily to declare a par value. Needless to say, the 85 per cent rule assures the United States a veto on any decision, even if favored by the other 128 members of the Fund.

Can this be called a major reform?

Yes, in terms of previous official commitments and intentions. It certainly reforms the Bretton Woods system most radically—by burying it. And nothing, certainly, could be further from the initial intentions of the official negotiators than the proposed gold and exchange-rate reforms. How many times did they proclaim that every aspect of the international monetary system would be reviewed, except two unanimously agreed to be the pillars of any future system, as well as of the then-existing system: stable par values and an unchangeable $35-an-ounce gold price?

Jamaica, on the other hand, hardly reforms the present system. It essentially proposed to legalize what now exists, i.e., the widespread and illegal repudiation of Bretton Woods commitments, without putting any other binding commitments in their place. Glaringly absent are any specific and operational provisions regarding the problems previously regarded as crucial: global *liquidity, adjustment*, and *convertibility*. Are all these problems really solved—as some would maintain—by the simple abolition of the par-value system? Were they really all the mere by-products of a gigantic mistake—Bretton Woods?

This is not a unanimous view, as shown by two passages of the Communiqué that salvage from the wreckage some brief references to the need for a provision "making the special drawing right the principal reserve asset" and "promoting better international surveillance of international liquidity" and to continued consideration by the Executive Directors "of the subject of a substitution account without delaying completion of the Comprehensive Draft Amendment."

Since the Draft Amendment is expected, according to the Communiqué, "within the coming weeks," I would be happily surprised if the Executive Directors could complete in time any significant and operational agree-

ment about matters which have eluded agreement for years and on which no progress is so far perceptible. On the contrary, the absence of any restraints on the inordinate growth of reserve currencies and the impact of the *de facto* or *de jure* revaluation of gold holdings on global liquidity make it practically inconceivable that the amended Articles could succeed in "making the special drawing right the principal asset in the international monetary system."

Any hopes that might still be entertained in this respect were quashed, to my mind, by the reported opposition of the U.S. Treasury to even the modest but ingenious start in this direction recently suggested by Mr. Witteveen that an agreed portion of global monetary reserves be kept in SDRs. (I apologize for remembering a similar suggestion of mine, fifteen years ago, in *Gold and the Dollar Crisis*, New Haven, Yale University Press, 1960, p. 106.) Mr. Simon said in his press conference that "the word 'control' gave him great difficulty. The implication is that the United States does not want to explore this issue now with any urgency" (quoted in the *New York Times*, Jan. 10, 1976). With no new reform initiatives or further meeting of the Interim Committee expected until the annual meeting of the Fund in Manila, it is fair to conclude that all hope for substantive reform must be put on ice for a considerable time to come.

Getting Back on Track

Let me continue on a less dreary note.

First, the end of reform is not the end of the world. Enough survives of postwar habits of bilateral and multilateral consultation and cooperation to give us hope that widespread recourse to restrictions and beggar-my-neighbor policies will be avoided, even if this requires huge salvage operations to help countries in difficulties. Unable to negotiate the fundamental reforms that would make the international monetary system less prone to crises, our officials have nevertheless demonstrated repeatedly an uncanny ability to mount, nearly overnight, the rescue operations needed to minimize their deflationary—if not their inflationary—impact upon the world economy. I am willing to trust them to persevere on this path for a long time to come.

Second, future events and crises will continue to trigger reforms unanticipated and even adamantly opposed by bureaucrats and officials. I mentioned above the fact that the two most fundamental reforms of the Bretton Woods system so far—flexible exchange rates and gold prices—are the only two that negotiators had long proclaimed to be beyond the pale of consideration. The Jamaica Agreement will not stop the evolution of the system any more than, let us say, the Smithsonian Agreement.

Two of the mainsprings of future reforms are already clearly perceptible.

The first is the rebellion of the less developed countries and their call for a basic re-examination of the world economic order. I invite you to read in this respect the interim, and soon the final, report of the Tinbergen Committee on Reviewing the International Order (RIO) and to follow the debates of the North-South Conference on International Economic Cooperation.

The second is the development of regional cooperation and integration in various parts of the world. No single country, or even group of countries, is likely to be able to reassert, in the foreseeable future, the kind of world leadership and influence that dominated in fact—and even partly in law—the actual functioning of the Bretton Woods system. The United States and the weak but still mighty U.S. dollar will undoubtedly continue to enjoy or bear enormous influence and responsibilities throughout the world—and not only in a rump "dollar area"—but far less exclusively and uniformly than in the past. The dollar has ceased to be—and is unlikely to become again—the universal benchmark or "center of gravity" for national exchange-rate decisions and interventions. It will increasingly share this role with other national or regional currencies, in a manner dependent on the actual pattern of each country's major trade, financial, and political relationships with other countries and groups of countries.

The Role of the European Community

Particularly important in this respect will be the evolving pattern of exchange-rate and other arrangements among the countries of the European Community. Their trading "center of gravity" is with one another, rather than with the United States, since their mutual trade absorbs on average more than 50 per cent of their total trade—from a low of about 30 per cent for the United Kingdom to a high of nearly 75 per cent for the Benelux countries—as against 8 per cent for their trade with the United States. An emerging exchange-rate area among the countries of the Community would be likely to draw into its orbit not only the other countries of Western Europe but also those of Africa and the Middle East, whose exports to the Community also approximate or exceed 50 per cent of their total trade, or five to ten times their exports to the United States. Such a broad, European-centered exchange area would account for about 75 per cent of those countries' exports, as against 8 per cent for their exports to the United States. (See my article on "The Community and the Disruption of the World Monetary System" in the March 1975 issue of the *Banca Nazionale del Lavoro Quarterly Review*, Annex III, and particularly the table on p. 34.)

While the considerations above can be expected to have a strong influence on national policies, these policies will not be uniformly successful. Nor are they likely to be embodied uniformly in binding agreements and commitments. Policies will continue to differ among member countries of the Community, countries "associated" with the Community in a somewhat looser fashion, and countries or groups of countries, such as an Arab group, without any formal membership or association status. Even among the members of the Community, some countries, such as the members of the "snake" arrangements, are likely to progress further and faster toward ultimate Community goals than some other countries still unable to accept and implement the policy commitments necessary to elicit substantial lending commitments from their partners. Even for this core group of countries, irrevocable and effective exchange-rate stability cannot be expected until adequate transfers of jurisdiction from national to Community agencies have been accepted and implemented. All that can be hoped for in the immediate future is a substantial enlargement of financial commitments to mutual monetary assistance, together with and subordinated to the development of close and binding consultation on adjustment policies, not excluding agreed exchange-rate changes in case of excessive or lasting disequilibria.

Institutional arrangements for such consultations, stabilization interventions in the exchange market, and mutual credits and their repayment would be immensely facilitated by the adoption of a common exchange unit—probably dubbed "Europa"—and its actual use as a market instrument, notably for the vast and growing volume of transactions already conducted today in Eurodollars and other Eurocurrencies. The European Fund for Monetary Cooperation would assume in this context a major role in the management of its members' exchange reserves, and evolve gradually into the federal reserve system of the future European Monetary Union.

Finally, the pace of progress of these European exchange and monetary arrangements will depend vitally on the ability of member countries to iron out among themselves and with the United States acceptable rules and criteria for joint decisions regarding exchange rates and exchange interventions vis-à-vis the dollar. Effective consultation among the countries of the Community in this respect will be greatly eased if the United States favors such consultation, easing thereby also the negotiations between the United States and a Community speaking with a single voice. It will be made more difficult if the United States puts its main emphasis

on bilateral negotiations, or on multilateral negotiations in other groups, such as the Group of Ten, of Five, or of Six as in Rambouillet, susceptible of dividing rather than uniting the Community itself. Equally or even more important will be the success or failure of the U.S. efforts to restore confidence in the future strength of a now inconvertible dollar.

Similar considerations will apply to the evolution of other existing or emerging regional groups in Eastern Europe, the Middle East, Asia, and particularly Central and Latin America, but none of these can be expected to be as important and influential as Western Europe for the likely shape of the international monetary system that will in a more distant future take the place of the defunct Bretton Woods system.

Another political factor of major importance in the months and years immediately ahead is the power conferred on the OPEC countries by their still huge balance-of-payments surpluses on current and on overall account. So far, they have wisely shown little interest in investing these surpluses in gold metal at current market prices. They have increased sharply their imports and their assistance to some other less developed countries, but a few of them are still left with huge receipts which they can only hold or invest in the United States and other major financial centers, conferring on the recipient countries and institutions the awesome power and responsibility of "recycling" these funds in the light not only of financial and economic considerations but also of political or military and even occasionally humanitarian ones!

Their long-run interests might well dictate a switch from such investments into an SDR type of reserve asset, as it is clear retrospectively would have been in the interest of the former major surplus countries of Europe, and of Japan.

Conclusion

In brief, the most probable evolution of the international monetary system in the foreseeable future is toward uninterrupted ad hoc bilateral and multilateral consultation among many countries and emerging currency areas, necessary to fill the gap left by the collapse of worldwide rules and commitments and to avoid a relapse into the disastrous free-for-all and *sauve qui peut* policies of the 1930s.

If and when progress toward some sort of predictable world order proves feasible, it is most likely to begin with regional agreements—particularly in the European Community—and to influence and mold the later reforms negotiable on a worldwide scale. The latter, however, are clearly incompatible with the continued assertion of full independence,

with unilateral decisions, and with veto rights by any major country, such as claimed by the United States in Jamaica.

Meaningful *world* monetary reform will continue to be blocked until some future U.S. administration repudiates and reverses the "new economic policy" and philosophy proclaimed by President Nixon on August 15, 1971. Contrary to his bright promise, that policy halted neither inflation nor unemployment in the United States and elsewhere, nor did it restore "the position of the American dollar as a pillar of monetary stability around the world."

THE BENEFITS AND COSTS OF AN INTERNATIONAL MONETARY NONSYSTEM

John Williamson

The significance of the agreements reached in Jamaica in January 1976 is that they make provision for legalizing the existing nonsystem governing international monetary relations. In place of the explicitly specified and reasonably coherent sets of rights and obligations that constituted the Bretton Woods system, which more or less functioned until August 1971, or the comprehensively redesigned successor system sought by the Committee of Twenty (C-20), the world is to function on the basis of a set of conventions and practices that have evolved out of a mixture of custom and crisis.

The formal international obligations that remain in the monetary field are minimal. Countries that have accepted the IMF's Article VIII—broadly speaking, the developed countries and some of the oil exporters—are obligated to maintain current-account convertibility; members of the Special Drawing Account must still accept SDRs at a well-defined price when designated to do so by the IMF; all IMF members must permit the use of their currencies in IMF drawings; and those in debt must still repay their debts. Beyond this, however, countries are in large measure free to do as they please. They can impose capital controls if they so desire but cannot be forced to do so. They are not limited in the size of the reserves they can hold, as under a reserve-indicator system, or in the composition of their reserves, which can be held in SDRs, gold, or currencies (in the issuing country or in the Euromarkets). They can accept gold or currencies if they want to, at a price of their own choosing, but they are not compelled to accept or surrender either at a particular price, or at any price (i.e., there is no asset settlement). They can peg their currencies if they want to, to anything they choose except gold—to any other currency, a composite of several currencies, including the basket SDR, or by mutual pegging, as in the European snake. They can do so within any margins they choose, and they can change the peg gradually, as under the crawling peg, or by large steps, as under the adjustable peg, apparently without the need for explicit Fund endorsement as was previously necessary under Article IV.5. Or they can let their currencies float, intervening as and when they please, subject only to the rather weak restraints on aggressive intervention provided by the IMF Guidelines adopted in June 1974.

All this is a far cry from Bretton Woods or the ambitions of the C-20. But that is not to say that it is worse. A written constitution has the advantage of providing an explicitly endorsed framework of rules within which to resolve disagreements according to agreed procedures. But if the rules themselves are such as to compel inefficiency or provoke disagreements, an unwritten constitution may well prove preferable. An evaluation of the existing nonsystem therefore requires enumeration of particular benefits and costs in comparison with defined alternative sets of arrangements.

A first benefit of present arrangements concerns the exchange-rate regime. A central fact of international monetary life is that the development of capital mobility has rendered the continued use of the adjustable peg impracticable. The reason is fundamental: under capital mobility, exchange markets can be in equilibrium only if all existing stocks of the several currencies are willingly held, which requires either that the stocks themselves be adjusted according to the gold-standard "rules of the game" or that the expected yields of different currencies be adjusted in order to satisfy the conditions of asset-market equilibrium.

Governments show no signs of being willing to play the gold-standard game, for the compelling reason that it disrupts internal stabilization policy. And expected yields, which consist of own interest rates plus expected rates of currency appreciation, cannot always adjust, because acceptable interest-rate differentials cannot offset anticipations of discrete changes in exchange rates, and exchange rates cannot always be allowed to adjust without making a mockery of the very idea of a par-value system. Hence, as capital mobility develops, the adjustable peg is bound to generate a series of ever more disruptive crises—as, indeed, it did from the early 1960s to March 1973. This basic inadequacy of the Bretton Woods system was the principal reason for its collapse. (This case is argued in some detail in my forthcoming book, *The Failure of World Monetary Reform, 1971-74*, London, Nelson, Chap. 3.) Nevertheless, only three weeks after the collapse of the adjustable peg and the move to generalized floating in March 1973, the C-20 decided that the reformed system was to be based on a resurrected adjustable peg.

The first and overwhelming benefit of existing arrangements, in comparison with both the Bretton Woods system and C-20 aspirations, is therefore that they make no attempt to force countries to revert to the adjustable peg and do not envisage any such attempt in the future, unless 85 per cent of the IMF membership are prepared to vote for such a reversion, which is an eventuality that can safely be disregarded. Instead, they allow the maintenance of the system of generalized managed floating that

replaced the adjustable peg, and this provides the viable crisis-proof adjustment mechanism that the Bretton Woods system lacked.

The adoption of managed floating has also defused the most potent sources of controversy in international monetary relations. In particular, the problem of distributing the obligation of initiating necessary adjustments is no longer the explosive issue that it was during the 1960s or was perceived to be in the C-20, where it underlay the major controversies surrounding the U.S. proposal for a reserve-indicator system and the European insistence on asset settlement. There are two reasons. First, the economic burden of undertaking adjustment is no longer associated with the act of taking the initiative, as it was when adjustment was to be effected by deflation or inflation at a fixed exchange rate. Second, the act of changing the exchange rate no longer requires a formal initiative, with its implications for national prestige, as it did under the par-value system. Another important way in which floating has defused past controversies is that the rest of the world is no longer obliged to follow U.S. monetary policy, as it was under the *de facto* dollar standard spawned by the Bretton Woods system in the late 1960s.

A second benefit of existing arrangements is one that it is sad but nonetheless realistic to record as an advantage: the fact that perpetuation of the *status quo* is diplomatically undemanding. Countries are not at present favorably disposed to undertake formal commitments, even if these involve no sacrifice of national interests, unless there is a rather immediate gain to be realized.

The obverse of this second benefit is that current diplomatic tranquility is bought at the cost of possible tension in the future. Without a set of rules governing national behavior in the international arena, there is an ever-present possibility that inevitable differences in national interests will provoke international conflict. There is also a strong case for wanting to see rules (and, indeed, practices) that are broadly symmetrical as between countries, as the C-20 sought. Differences per se can foster grievances: even where differences imply both advantages and disadvantages that may seem reasonably balanced to an impartial observer, it is only to be expected that countries will focus attention on the disadvantages to themselves and the advantages to others.

In addition to this political disadvantage of existing arrangements, a series of economic costs attach to the present nonsystem in comparison with a reformed system of the general character sought by the C-20.

The first relates to the degree of volatility that exchange rates have exhibited during the period of floating. It is an established historical fact that exchange-rate variations have been pronounced under floating and

have exceeded those under the par-value system on just about any measure, despite the occurrence of substantial central-bank intervention designed to smooth rate fluctuations. These movements have often been reversed, rather than always being explicable as prompt adaptations of rates to changes in underlying conditions. It seems doubtful whether the agreement reached at Rambouillet and endorsed at Jamaica to "act to counter disorderly market conditions or erratic fluctuations in exchange rates" will substantially change this situation. Just how costly this exchange-rate volatility is in impeding international transactions is very much open to question, but it strains credulity to imagine that it does not have any antitrade bias at all.

The second economic cost of existing arrangements is the total lack of control over the volume of international liquidity, which arises from the absence of asset settlement, the unconstrained freedom to place reserves in Euromarkets, and possibly also from fluctuations in the value of gold reserves that may result from variations in the gold price. It can be argued that variations in the foreign-exchange component of reserves are unlikely to be a major disruptive force, inasmuch as floating gives countries individually far more power to avoid major unintended reserve accumulations or losses than the par-value system did, and the danger of a major general surfeit or shortage of reserves emerging and provoking global inflation or deflation is therefore substantially reduced. However, no such reassurance exists so far as the gold component of reserves is concerned. The Jamaica Agreement gives central banks the freedom to trade gold among themselves at mutually agreeable prices. If it transpires that a willing buyer at a near-market price can always be found when a central bank wishes to sell (which is a possibility, though perhaps not a probability), the Jamaica Agreement may reverse the *de facto* demonetization of gold that occurred in August 1971. If gold is thus effectively remonetized, any new speculative bubble in the gold market would increase the value of gold reserves, and countries in general could find their reserves carried far above their optimal level. The fact that exchange rates were floating would then do nothing to prevent a competitive scramble to dispose of excess reserves, with inflationary consequences or even attempts at inconsistent intervention.

The third unsatisfactory economic aspect of the present situation, at least in the eyes of many, is the maldistribution of the seigniorage that results from reserve creation. With the present elastic supply of reserves, it seems unlikely that sufficient reserve stringency could develop to convince the necessary 85 per cent of the IMF membership that new SDR allocations are called for. Seigniorage will therefore continue to be dis-

tributed arbitrarily to reserve centers and perhaps to gold holders, rather than on the agreed basis reflected in the distribution of SDR allocations.

A fourth aspect concerns the continued asymmetry in the position of the U.S. dollar, which has been aggravated rather than ameliorated by the switch to managed floating, inasmuch as the asymmetry formerly consisted of U.S. inability to influence the exchange rate of the dollar within the margins, and the margins have now been extended from 2¼ per cent to infinity. (The United States always had the right to change the par value of the dollar; she was merely reluctant to exercise it, for reasons that were understandable under the adjustabe peg.) It is conceivable that the ability of other countries to manipulate exchange rates so as to contribute to stabilization policy, and the inability of the United States to defend herself against manipulation, will lead to a significant intensification of the problem of demand management in the United States.

There are other reasons for fearing the weakness of existing defenses against the pursuit of aggressive payments policies. It is true that the Guidelines for Floating provide some defense against overtly aggressive policies, but the defenses are weak ones. The speed with which the industrialized countries have passed the oil deficit on to the primary producers is a worrying example of what can happen when sharp conflicts of national interests over payments objectives exist and there are no effective international constraints on the pursuit of national self-interest.

None of these costs is of comparable importance to the benefit of having a workable exchange-rate regime in place of the adjustable peg. Yet collectively they are important enough to make it worthwhile considering whether it is possible to devise arrangements that might reduce those costs without reintroducing the brittleness of the adjustable peg. In my view, there is reason to suppose that this would be technically feasible. The key need is for an exchange-rate regime that retains the flexibility of managed floating but also embodies an official and agreed view as to what rates ought to be, to provide a fulcrum for international management. The "reference-rate proposal" suggests precisely this. It envisages the negotiation of an agreed structure of reference rates that would be regularly revised at prespecified intervals. It only forbids countries to intervene to push rates away from their reference rates, rather than compelling them to intervene to hold the rate close to a particular rate, which is the obligation that creates the one-way options that are the fatal weakness of the adjustable peg. (The proposal is that of Wilfred Ethier and Arthur I. Bloomfield, *Managing the Managed Float*, Essays in International Finance No. 112, Princeton, N.J., 1975, and has been discussed in Chap. 9 of my forthcoming book as well as in my paper, "The Future

Exchange Rate Regime," *Banca Nazionale del Lavoro Quarterly Review* [June 1975].)

Adoption of this proposal, which is a natural evolution from the IMF's existing Guideline 3, might go a considerable way toward alleviating the first, fourth, and fifth of the economic costs of the present nonsystem, enumerated above, and would lay a foundation for possible subsequent introduction of asset settlement, which is an essential condition for establishing control of international liquidity and permitting future reserve growth to take the form of SDRs. (There would of course remain other problems, such as that of securing control of reserve placements in the Euromarkets and, if gold proves as popular with central bankers as its friends believe it will, of bringing the gold price under control to the extent needed to prevent any new speculative bubble from having disruptive effects on international liquidity.)

Desirable as such developments may be, the chance of their occurring cannot be rated very high, if only because existing arrangements seem unlikely to generate those crises which are apparently a precondition for the achievement of international agreements. That means that the existing nonsystem is likely to persist without major change for some time. The Jamaica Agreement is helpful in adapting the IMF Articles so as to enable the Fund legally to play its modest but useful role in organizing get-togethers where the international financial establishment can rub shoulders with one another and thereby wear down their nationalistic edges, and in serving in a fire-brigade role to keep the developing countries from disaster.

The Fund's ability to fulfill the latter task has been aided by most of the specific agreements endorsed at Jamaica—those relating to the increase in quotas and the temporary increase in the size of tranches, the liberalization of the Compensatory Financing Facility, and the establishment of the Trust Fund to be financed by sale of part of the IMF's redundant gold stock. On the other hand, the unprincipled decision to increase international liquidity by "restituting" a part of the IMF's gold without any pretense of first establishing a need for increased liquidity is a graphic demonstration of just how far the ideal of purposive international management has been eroded. The lesson of the train of events that culminated in Jamaica is, however, that purposive international management is rather less critical in the monetary sphere than in many other aspects of international economic relations. Hence, it will be no bad thing if, as now seems to be the trend, the monetary component of international economic diplomacy greatly recedes in importance.

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92. Samuel I. Katz, *The Case for the Par-Value System, 1972.* (March 1972)
93. W. M. Corden, *Monetary Integration.* (April 1972)
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* 95. Tom de Vries, *An Agenda for Monetary Reform.* (Sept. 1972)
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* 98. James C. Ingram, *The Case for European Monetary Integration.* (April 1973)
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111. Gerald A. Pollack, *Are the Oil-Payments Deficits Manageable?* (June 1975)
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[1] Essays 62, 67, 71, 73, 75, and 88; Studies 12, 14, and 15; and Reprints 4, 6, 7, 8, 9, and 10 are still available from the Section. For a complete list of publications issued by the Section, write to the Section or consult the publications list in Essay 91 or earlier.

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