2. Wolfgang Rieke:

I believe it was Karl Popper, the philosopher, who said that there was only one justification for a lecture: that it should be a challenge (" Herausforderung ") for the listener. Popper was drawing a distinction between the spoken word and the printed text when he said this. But I was reminded of his remark when I read Padoa-Schioppa's paper. I consider it quite a challenge to have to comment on it, for various reasons. The paper is entitled " Topics for Discussion " and later referred to as " an annotated agenda." This is surely a modest claim for a paper which reaches far into the subject, asks the pertinent questions, suggests possible answers, and above all, provokes hard thinking on a number of important issues. The subject may well occupy some of us even more intensely in the coming months than did the preparation of the EMS as it is functioning at present. Hence we have every reason to be grateful for this paper.

In my comments I will not be able to be exhaustive; I will have to be selective. Let me start by saying that I wholly, or wholeheartedly, agree with the premise of the paper as stated early on and re-affirmed elsewhere, namely "... that the whole system should be organized in such a way as to be an instrument to fight inflation in the Community, and that the first meaning to give to the establishment of a 'zone of monetary stability in Europe' should be in the sense of price stability rather than exchange rate stability." All the major parts of the system should indeed be so designed as to comply with this general premise.

Those of us who feel that there has been somewhat too much emphasis on the mechanics of the exchange rate arrangements, and perhaps too little concern for the fundamental conditions of success of the EMS will not fail to note the difference. The preparation of the next stage of the EMS should provide the opportunity to correct the balance somewhat. If we can agree on the proper safeguards to be built into the European Monetary Fund we will have less reason to fear a new " institutional breach " to inflationary processes of which we are warned at the end of the paper. But will we be able to agree on such safeguards?

I. Turning to the *credit mechanisms,* the main concern is how to make sure that they are used, when they are used, in support of policies, internal as well as external, that are consistent with overall equilibrium and adjustment of the balance of payments of the country using them. To me the discussion about the credit facilities seemed always somewhat *unreal.* Large credit facilities were considered a necessary complement of the exchange rate arrangements. At the same time, there was evidence — and I think there still is — that countries might in fact not wish to make the intended use of them. Especially when considering the case for greater conditionality one is reminded of the experience of the IMF with drawings on the conditional credit tranches. There are at present no drawings in the credit tranches outstanding by industrial countries. It was not surprising then that it was argued that large credit lines were mainly to serve as an impressive " fleet in being " to intimidate operators in the exchange markets, not so much to respond to a real and foreseeable need to finance large balance of payments deficits.

Such reasoning has hardly calmed the concerns of potential surplus countries in the system that they might have to accept the monetary effects of large-scale intervention supported by too large credit facilities. These concerns are still present and will probably remain so.

In the old " snake " the risk of the monetary effects of intervention growing to be too large was, at least at the outset, substantially more limited: countries' exchange reserves were much smaller, credit lines less generous and other credit both within the system and outside was less readily available. Individual countries could not easily " create " reserves needed to settle balances within the system, in the way the United States was able to do because of the privileged role of the dollar. Yet especially in its final stages intervention in " snake " currencies reached very large volumes at times despite the limited number and size of countries participating in the system apart from Germany. For example, from July to October last year some 10 billion D-marks and from July to September 21 (date of the currency re-alignment) nearly 7 billion D-marks.

EMS countries' reserves are so much larger now, as are the credit facilities, and there is the international banking system always ready to provide additional loans. If these are mobilized to support large-scale intervention, the EMS could well take on characteristics of the dollar-based Bretton Woods system: asset settlement would become a pure formality; intervention a totally one-sided obligation; and the monetary effects for the surplus countries would eventually be just as unacceptable. All this needs no further illustration.

Notwithstanding a general sympathy for conditional credit, I would be somewhat hesitant about *undue* reliance on *conditionality* to meet some of the concerns expressed by Padoa-Schioppa. As stated in the IMF's Annual Report, " Adjustment measures typically relate to sensitive areas of fiscal, credit, incomes, and exchange rate policies" etc., "and governments are *rightly* concerned about the compatibility of these policies with their economic priorities and their domestic, social, and political objectives." The arguments for and against attaching conditions to *short-term* credits obtained to bridge over a liquidity shortfall should be weighed carefully. Even if provided through a future EMF, such credits would essentially be extended by one central bank to another. Within the short periods for which credits are provided, control over the implementation of measures imposed under conditionality would always be difficult if not impossible. Conditionality without such control of effectiveness could hardly be taken seriously. It would be useful, however, if agreement could be reached that a deficit country whose currency is in need of support should in general accept the monetary consequences of any payments deficit rather than neutralize it.

A brief remark on the relative size of the very short-term and short-term facilities. It seems to me that only at first sight do the latter look somewhat inadequate, as Padoa-Schioppa says, in relation to the unlimited very-short-term financing of intervention in EMS currencies. The fact is, that only the *automatic* extension of very short-term financing is limited to the short-term debtor quotas. The Central Bank Agreement specifically provides for prolongation exceeding this limit by mutual agreement. In other words, even fairly large intervention claims and liabilities may be carried over for quite a number of months from the date of original maturity. The Agreement also provides for an examination by the Committee of Governors of individual situations with a view to activating short- or medium-term credits up to the fairly large limits provided under these facilities (including drawings under the so-called " rallonges "). In the case of Italy, to which Padoa-Schioppa refers, I believe that the short-term credit of 1.6 billion EUA was prolonged twice before being converted into a medium-term credit.

On the whole, experience with Central Bank cooperation supports the conclusion that any reasonable call for assistance is in fact met in a flexible manner.

II. A far as the *exchange rate arrangements* are concerned, the order of the day is likely to be for some time to come, both within EMS as in relation with the dollar: " As much stability as possible, as much flexibility as needed." It is not easy to give concrete operational content to this banal sounding formula. One possibility is indeed that the EMS will have distinct features of a " *crawling peg* without formal decision rules about the size or frequency of the crawl," as Padoa-Schioppa says. In relation to the dollar it is not unreasonable to assume that we will continue operating a *floating* system with varying degrees of active management according to circumstances.

In such a " double faced system, " the D-mark may well occupy a somewhat special position, not by choice, but on account of the special quality it has assumed as an alternative to the dollar. It would hardly be wise to try and work out too precise and possibly complicated rules for the operation of such a system. Even the definition of such rules, let alone their application, could easily give rise to unwarranted expectations and speculation in the markets.

One *theoretical* possibility, which was suggested many years ago by the German " wise men " (Sachverständigenrat) for the D-mark, would be a pre-determined quasi-mechanical crawl. However, I presume it is difficult to perceive this working smoothly in a multi-currency type system like the EMS, when it was already found unpalatable for one currency in an n^{th} currency type world. It would moreover by definition be in conflict with the political philosophy of the EMS.

Dollar rates are likely to continue floating. There is no alternative in sight, given the enormous potential for capital movements and the many unforeseeable influences bearing on the dollar from one day to the next. Of course, conditions for greater stability of the dollar have improved to the extent that U.S. monetary policy is more directly geared to fighting inflation and restoring overall balance in the economy. But the cost and price differential (in the broadest sense) vis-à-vis the dollar is only one determinant of the dollar exchange rate of various currencies, and not a very reliable one at that.

If it is true that variations in the dollar rates affect EMS countries' effective exchange rates only moderately if taken by themselves, then this might facilitate acceptance of the unavoidable, namely a common floating EMS system against the dollar, much like the original concept of the " snake " when it lost its tunnel. With stability oriented policies in the United States and in Europe, a floating dollar need not be unduly volatile. There is ample evidence that business and banking are on the whole more concerned that exchange rates should be realistic than that they should be absolutely stable. Their appreciation of what is realistic may sometimes be questionable, but so may be that of the authorities. Modesty in regard to central banks' control over exchange rates is probably still indicated.

basket average, there is always the question what is in the basket itself. So Scott Pardee's remark may be relevant here as well.

As we are preparing for the setting up of a European Monetary Fund, inevitably the institutional questions move into focus. The choice of possible solutions follows from the functions and responsibilities with which the Fund is to be endowed. But the argument also goes the other way: the institutional set-up will determine the scope of such functions and responsibilities as may be conferred on the new Fund. There are major differences of institutional set-up in the various countries of the Community. To put elements of these simply into a basket and put a label 'EMF' on it might well be hazardous, but the temptation will be great to do just that. The lack of progress in convergence of economic performance and policies towards a zone of economic and monetary stability as defined by Padoa-Schioppa, partly due to external influences but not exclusively so, may encourage some to put particular trust in new institutional solutions. Others will no doubt want to insist on even greater safeguards than they might otherwise be content with. It surely is not an easy time to discuss these questions.