A Modest Step Towards Fixed Parities*

1. The experience of the last ten years has keenly disappointed those, including myself, who thought that floating rates would have lessened inflation, unemployment and balance of payments disequilibria. In addition, daily fluctuations of exchange rates have recently become too sharp, imposing unwelcome risks on business enterprises. Whether the failure of the floating system was due to continued intervention in the market by national monetary authorities, to mismanagement, to external events such as the oil explosion or to the differential rates of inflation, all this does not greatly matter.

Some may think that part of the explanation is to be found in the near absence of concerted action at the international level and in the lack of political will to manage floating by international decisions and by a better coordination of exchange rate and interest rate policies.

It has always been realized that freely floating rates could not solve simultaneously the problems of liquidity, arising from temporary and reversible external imbalances, and those of adjustment arising from fundamental disequilibria. Private speculation did not perform the stabilizing role we all expected of it. On the other hand, depreciation of a currency as an instrument of adjustment proved inadequate owing to its feed-back effects and to the existence in some countries of a large measure of indexation. The appreciation of a currency has proved in many cases successful in keeping down external inflationary pressure but has not helped so much in restoring balance of payments equilibrium.

This sense of dissatisfaction with the functioning of the floating rate system has been one of the reasons for the move in Europe towards regional monetary integration, starting in the early Seventies and leading to the creation of the European Monetary System.

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2. The urge towards more stable exchange rates, even to fixed parities, is becoming more intense. In particular, fixed parities are viewed as a better instrument than fluctuating rates in compelling national authorities to follow correct economic policies and to abide by monetary discipline.

Some people may think that a return to gold, i.e. to an international standard over which individual national authorities have no control, would solve the problem after ten years of mistakes and misgivings. Others may think that gold will never be on the monetary agenda again and that a reconsideration of the problem along these lines betrays a failure to appreciate present realities. The price of gold has been too volatile to become once again a stable measure of values to which currencies could be linked and in which they could be made convertible with some enduring confidence.

Some people would look at SDR, or even better at an improved SDR, as the appropriate standard for such purposes. But this is a long term perspective, because SDR still forms a small fraction of international liquidity and because the "substitution account" — which would have gone a long way towards enhancing the instrument — has been shelved.

Whatever the standard — gold or SDRs — we must not again overlook the fact that it has to be not only a common denominator of currencies, but also an instrument for the conservation of value. A not insignificant cause of the break down of the Bretton Woods gold-dollar standard was the refusal to implement the IMF Articles of agreement concerning uniform changes in par values.

3. In view of the uncertainties as to the future approach to a possible return to a par value system based on an international standard, we might envisage a number of intermediate steps which would not prejudge the final choice. We must recognize that:

— the aim to be attained is convertibility at fixed rates of national currencies held by non-residents into an acceptable international monetary standard and that this aim can be attained only gradually;

— the choice of the standard should for the time being be left open for future decisions;

— the choice has to be made only when inflation has been reduced to manageable proportions and when differential rates of inflation between industrial countries have disappeared;

— in the meantime we have to enhance both the role of SDR and gold;

If we accept these assumptions, the intermediate aims could be identified as the following:

— gradual stabilization of exchange rates;

— gradual stabilization of the price of gold; and

— mobilization of gold, which is now a very illiquid asset, to be achieved along with its increasing monetary role and the increasing role of SDRs.

The attainment of such intermediate aims is desirable in itself, independently of the above-mentioned final aim, because it would introduce into the system a degree of stability beneficial to the improvement of economic relations between countries.

4. The gradual stabilization of exchange rates, given the existence of three main distinct monetary zones (EEC, dollar and yen) whose currencies fluctuate freely against each other, could be pursued in the framework of a tripartite monetary agreement.

Flexible bands of fluctuation could be agreed upon between the three main currencies (ECU, dollar and yen), possibly after the entry of the UK into the EMS. Margins could be fixed at plus-minus, say, 10 percent above and below a central "equilibrium" rate. Margins could be progressively restricted. Margins should be defended by interventions in the market using, in addition to currency reserves, the proceeds of central banks' swaps, IMF drawings, proceeds of SDRs and/or gold sales and so on. The central rate could be changed by common agreement in the presence of a fundamental disequilibrium and possibly within the margins of fluctuations. In this context, a divergence threshold of the EMS type could also be considered.

Stabilization of exchange rates, to be successful, has to be accompanied by close coordination of interest-rate policies. In 1980, the US prime rate swung from 20 percent in April to 10 percent in July and to above 20 percent at the year end. Such a

high rate is clearly depressing for the world economy at large (US production represents around 40 percent of the global production of the industrial world), not so much because of its level in nominal terms, but because of a very significant divergence with the rate of inflation. US has at present a real rate of interest higher than in most industrial countries. As Germany and other countries will presumably follow the same course by restricting liquidity, the depressing influence of high real rates will spread.

5. Stabilization of the price of gold is a necessary prerequisite of a remonetization of gold, if such a development is deemed desirable. But it has some value in itself.

The experience of the gold pool in the Sixties is a model of the kind of stabilization to be avoided. Anyhow, it cannot now be followed because entirely different conditions (there is no official price of gold) make it impossible to operate in the same way. The principle of that model was to consider the official price of 35 dollars an ounce as the "true" price to be defended on the market.

Any method of stabilization has to avoid, at least initially, the pitfall which consists in predetermining the level at which the price of gold will be pegged. One of the procedures to be followed could be the following:

a) the BIS, acting as agent for a number of central banks, declares itself ready to buy and sell gold against dollars at margins respectively below and above a central price corresponding to the average of the market prices in, say, the previous three fixings;

b) the average of three fixings should be progressively enlarged to some 30 fixings or more in the course of the following months;

c) gold purchased and sold should be allocated to or supplied by the central banks participating in the stabilization programme in proportion to their gold reserves.

Any rising or declining trend of the market price of gold will thus be progressively slowed down. In the course of time, if an appropriate level of the price of gold is identified, the intervention price could be modified away from the averages of market prices indicated above.

6. Gold is at present a largely illiquid asset. In case of need, central banks cannot sell gold in the market without heavily depressing its price, except for very modest amounts, in order to finance balance-of-payments deficits. As in the case of Italy in the past, it can be used as collateral to obtain loans, although at the cost of to some extent impairing external standing and image. An attempt to make gold more usable for monetary purposes has been made in the EEC through the creation of ECUs, which are issued against the deposit, at three months' maturity, of a certain percentage of gold and dollar reserves of member countries.

Working on similar lines, gold could be made to re-enter the international monetary circuit. Some of the aims of the now defunct "substitution account" could also be achieved in the process by injecting dollars in addition to gold into the mechanism. One possible line of action could be the following.

Each future allocation of SDRs could be made available to IMF members in proportion to their quotas on the condition that the receiving member accept from the Fund an additional amount of SDRs, equal — say — to the double of the allocation as a counterpart of gold and dollars (half and half) deposited with the Fund at a renewable three months' maturity. At the maturity of the deposit, the amount of gold and dollars deposited with the Fund against SDRs will be adjusted to the prevailing market prices of the two assets.

Some IMF members — but this does not seem likely to happen — may not agree to swap gold and dollars against the additional distribution of SDRs; in that case, they would not be entitled to receive their basic allocation. The unallocated amounts of SDRs would be apportioned to those remaining IMF members in proportion to their quotas, on the same condition, ie. that they swap gold and dollars for the double of the allocated amount.

In the course of time, as exchange rates and gold prices become more stable thanks to the proposed tripartite agreement and to the interventions of the BIS, the SDR-gold/dollar transactions on a deposit basis could be transformed into direct sales of SDRs from the IMF to member countries against gold and dollars. Moreover, the 1 to 2 proportion of SDR allocations to SDR sales could be modified in favour of the latter.

Subsequent steps are now difficult to foresee. The evolution of the international monetary system could either move further towards fixed parities or stop at this stage for a lengthy period. Even in that event, considerable results would have been achieved: more stable exchange rates, stabilization of the price of gold, mobilization of gold for monetary purposes and enhancement of the role of SDRs.

In the meanwhile, a better coordination between EEC and US would be worked out, particularly in the field of interest rate policy.

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