

Reflections on New Currency Solutions

The Washington Agreement

1. - The Washington agreement of last December achieved an important result in one respect: through an adequate realignment of major currencies it corrected the overvaluation of the dollar, thus setting in motion a process of reabsorption of the fundamental disequilibrium between the U.S. and its main trading partners, to be completed in two years or so.

The main elements of the agreement are the following:

(a) an average weighted revaluation of the main currencies vis-à-vis the U.S. dollar of the order of magnitude of 10-11 per cent, capable of producing in due course a reversal of the current account balance of the United States of 9-10 billion dollars;

(b) the establishment of a temporary regime under which a member would declare to the International Monetary Fund a new par value or a "central rate" and would be allowed a fluctuation of its currency within margins of 2.25 per cent on either side of the new effective basic parity relationship with the intervention currency. The intervention currency is the currency, normally the dollar, that a monetary authority stands ready to buy or sell in order to perform its obligations regarding exchange stability;

(c) the undertaking by the United States to propose to Congress a devaluation of the dollar in terms of gold to 38 dollars an ounce as soon as the results of the trade negotiations with the EEC, Canada and Japan on short-term issues are available for Congressional scrutiny. In compliance with this undertaking the United States Government has presented on February 9 last a devaluation Bill to Congress, which will presumably act in conformity during the month of March;

(d) the removal by the United States of the 10 per cent surcharge and of the related provisions of the so called "Job Development Credit".

The Washington agreement has therefore fully succeeded in solving the immediate problems brought to the surface by the May-August exchange crisis; but no advance has been made, beyond the identification of the main issues, in solving the structural crisis which has plagued the international monetary system since the beginning of the sixties.

2. - However, the negotiation leading to the agreement and the results of the agreement itself have brought out a number of points which have some relevance for the future steps concerning the reform of the international monetary system.

First of all, in the course of the negotiation it has become increasingly apparent that the exchange relationships between currencies are much more important than their relation with gold. All along, the price of gold has been considered as a convenient yardstick to measure the relative realignment of currencies, i.e. an element — as Rueff would say — “purely conventional without relevant economic and monetary consequences”. A convincing proof of this can be found in the readiness on the part of the U.S. partners to accept, although temporarily, that the realignment be brought about through a revaluation of their currencies in terms of the U.S. dollar.

Secondly, as a related point, the devaluation of the dollar in terms of gold, although politically important,¹ has not revealed itself the traumatic experience that had been feared. This operation was rightly deemed to be fundamentally different from an increase of the price of gold and no major currency followed the dollar in its devaluing (only about 60 minor currencies did). It cannot therefore be said that the devaluation of the dollar, which technically cannot take a form other than an increase in the dollar price of gold, has enhanced the importance of the metal within the system.

Thirdly, it has become evident that any major change in the par value of a currency of an important industrial country affects the interests of all its main trading partners, if not of the whole

¹ From an economic point of view it is of course irrelevant whether a given realignment is brought about through a devaluation of the dollar, a revaluation of other currencies, or a mixture of the two — quite apart from the effects on central banks' balance-sheets; it is therefore incorrect to equate a devaluation of the dollar with the contribution of the U.S. to the burden of adjustment.

community of I.M.F. members. In fact, a multilateral negotiation — for which there was no precedent — was necessary in order to reach agreement on an adequate and differentiated realignment of the principal currencies; but this was an extremely delicate affair and it was almost a miracle that it ended in success. It might remain a unique event. Therefore, any future adaptation of exchange parities must be achieved gradually, in small steps, so as to avoid the need of a world-wide confrontation of interest that, in absence of a fair compromise, would be a disaster.

Finally, the outcome of the negotiation was the establishment, for the time being, of a *de jure* inconvertible dollar. Since foreign monetary authorities have undertaken to sell or to buy U.S. dollars at the intervention limits, nearly all I.M.F. members, with the possible exception of Canada, have practically agreed to become participants of the dollar area — a somewhat paradoxical result, which strikes at the very foundations of the Bretton Woods system, insofar as member countries of this organization would thus submissively accept the “exorbitant privilege” of one currency, however important, over all other currencies.

The Problems of the International Monetary Reform: Adjustment, Confidence, Liquidity

3. - The negotiators of the Washington agreement fully realized that the correction of the fundamental disequilibrium between the main trading centres was only one step in the solution of the deep-seated crisis of international payments. The three main problems which characterize such a crisis according to the opinions of most economists — the liquidity, the confidence and the adjustment problems — remain to be tackled. These problems, although bearing different names, are the same that were clearly identified in the speech of the Italian Minister of the Treasury at the last September meeting of the Group of Ten in London and in the intervention of the British Chancellor of the Exchequer at the last annual meeting of the International Monetary Fund, and subsequently found their place in the concluding paragraph of the Washington communiqué.

Let me deal with them in a sequence that in my own view reflects their relative importance.

4. - The *problem of adjustment*, which relates to the difficulty of Government to maintain balance-of-payments equilibrium while pursuing the fundamental objectives of economic policy (namely, stability, growth and full employment), has never found a satisfactory solution, or even the beginning of a solution, during the sixties.

Four main factors are responsible for this unsatisfactory state of affairs.

First, it has appeared difficult and somewhat illogical for countries, such as the United States, whose foreign component in the GNP is relatively small, to take into account balance-of-payments constraints in the formulation of economic policy. Secondly, the assignment of different priorities to the above-mentioned fundamental economic objectives, coupled with the necessity to take into account in varying degrees other regional and social aims, has resulted in different national propensities to inflation and therefore in balance-of-payments disequilibria, either temporary or fundamental. Thirdly, it has never been possible for a variety of motives, right or wrong, to use fiscal policy consistently, except for brief spells, for the management of internal demand and to direct monetary policy to external objectives; even when it would have been possible to direct properly the available policy instruments, their use has been delayed because of failure to recognize in good time the existence of an imbalance. Finally, changes in currencies' par values, the only effective instrument to correct fundamental disequilibrium, have always been long delayed, either because of an inherent asymmetry in the system (pressure to adjust has always been stronger on deficit countries than on surplus countries) or because of a reluctance by Governments to shoulder the responsibilities of the operation before public opinion and to accept for their countries the burden of economic adjustment.

All these reasons boil down to insufficient internal discipline and international cooperation in the conduct of economic policy.

I do not believe that such discipline could have been enforced and international cooperation fostered through the use of automatic mechanisms such as systematic conversions of foreign-held balances into gold: U.S. authorities reacted last August not so much to gold losses as to the appearance for the first time of a huge trade deficit. Among important countries, discipline cannot be but freely accepted and usually this is possible only up to the limit of conflict between internal and external objectives.

During the recent negotiations for the realignment of currencies, the main trading partners of the United States did not ask for an early resumption of convertibility, because such a demand would have been non-negotiable in view of the huge overhang of dollars within the system. The only reference to convertibility was relegated to the last paragraph of the communiqué as a vague aspiration, presumably for the mid-seventies. An opposite stance would have met with a flat refusal, as the non-committal attitude of the U.S. authorities toward the adoption of techniques designed to permit repayments of debts to the Fund clearly proves.

This shows that the U.S. are not ready to submit their internal economic objectives and policies to international scrutiny and discipline; nor are other countries probably willing to do so. The so called "benign neglect" is not an irrational attitude in itself; it is tantamount to saying that "at least for the time being, the United States are free to formulate their economic and monetary policies mainly with internal objectives in view; other countries are free to accept the validity of the market value of the dollar expressed in their own currencies".

What is less rational is the a priori undertaking of other countries to buy or sell dollars at a fixed price. This amounts to financing the U.S. balance-of-payments deficits or surpluses resulting from the U.S. economic and monetary policies. Unless we assume that the main industrial countries do not object at being members without vote of the dollar area, that undertaking clearly shows an inherent inconsistency.

My conclusion would be that, as long as the dollar remains inconvertible, the problem of adjustment between the United States and countries not belonging to the dollar area — and in particular between the U.S. and the EEC — should be solved through the free fluctuation of the dollar vis-à-vis the EEC currencies as a whole, the reciprocal relations of these latter being based on stable parities. Two other ingredients are necessary in order to ensure a smooth functioning of such a system: first, a control of short-term capital movements at the frontier of the area of stable parity relationships with the aim of preventing short-term flows from affecting trade competitiveness; second, an agreement for long-term capital movements of the type advocated, again recently, by Robert Roosa, in the same spirit of GATT, designed to make such movements between

monetary areas subject to acceptable standards of conduct and prevent undesirable investment flows.

Such a pattern of international payments, which assumes an organization of intra-EEC monetary relations along lines which I will shortly indicate, is not so distant an evolution as I was inclined to believe a year or so ago;² on the contrary, it now distinctly appears as a practical and immediate possibility. It does not imply in any sense an opposition of economic blocs, but a constructive cooperation between monetary areas while awaiting the time, not yet ripe, for the re-establishment of a stable exchange rate relationship for all IMF countries, based on a different code of behaviour from the one which has been followed during the sixties. Nor is it inconsistent with the Bretton Woods principles and practices. It is likely to lead to a reinforcement of the dollar as the speculation against this currency would cease to find support in fixed points of reference.

5. - Once the exchange rate relationships between great monetary areas are put on a floating basis, the remaining structural problems of confidence and liquidity might seem to have disappeared. But this is not the case.

In the first place, monetary authorities might wish to intervene in the markets in order to preserve orderly conditions of functioning, and this requires some kind of liquidity. Secondly, liquidity is needed among members of the stable parity area. Thirdly, to the extent that intervention is envisaged in the exchange markets by using U.S. dollars, and in order to create the conditions for a gradual resumption of convertibility of some kind — not necessarily gold convertibility — of the dollar and of the other currencies, the problem of confidence will have to be solved.

6. - The *confidence problem* is essentially the problem of replacing the dollar as a reserve asset in official holdings and of controlling or financing the shifts between private and official holdings of that currency.

² See my Princeton paper No. 97, July 1971 *Towards new monetary relationships* based on remarks made the previous February in a conference in Washington at the National Economists Club.

The dollar is the principal vehicle currency in which international trade and financial business are denominated and transacted. This role of the dollar has tremendously increased in the last decade, as the emergence and extraordinary development of the Eurodollar market have shown, and it will continue to expand quite independently of whether the dollar is convertible or not in reserve assets; as a matter of fact, the dollar is convertible through the market and is spendable against goods and services as well as against financial assets representing claims on real resources of which the U.S. markets provide practically unlimited quantities. No currency will be in a position to take over the vehicle currency function performed by the dollar as long as the United States maintain their industrial supremacy.

But the reserve role of the dollar is in question as it becomes increasingly clear that its preservation is incompatible with an efficient management of international liquidity and monetary arrangements.

Special drawing rights could take up the reserve role of the dollar as well as that of sterling, which performs the same functions but to a smaller extent.

The aims of a transfer of reserve functions from the dollar to SDRs are connected with the need to ensure a better management of international monetary arrangements; therefore, after the re-establishment of stable parities on the world scale:

(a) surpluses and deficits of present reserve centres would be financed through an increase or a decrease of their reserve assets and not through a reduction or an expansion of their liabilities. Consequently, convertibility obligations, when restored, would be discharged in an orderly manner, therefore contributing to a better functioning of the adjustment process;

(b) changes in the par value of the currencies of the present reserve centres would no longer cause exchange losses or profits to official holders. These centres would therefore feel free to change an inappropriate par value of their currency;

(c) greater international control would be assured over the global level of reserves.

Conversion of reserve currencies into SDRs, after an initial experimental period, would have to be mandatory in order to achieve fully the above-mentioned aims. Freedom of choice of individual

countries in this respect would open the way to a fresh accumulation of currency holdings with destabilizing effects on present reserve centres for the system as a whole. However, a limited range of freedom could be preserved by the understanding that the amount of working balances to be retained for intervention purposes should be established between a minimum and a maximum percentage of total reserves, let's say between 10 and 20 per cent. However it is not to be excluded that the same result could be achieved through other more pragmatic methods of stabilization of the present dollar overhang.

Movements of funds between the private sector and central banks could be treated as short-term flows to be dealt with through bilateral or multilateral swap networks or through the issue by the debtor of debt instruments expressed in the national currency of the creditor.

The counterpart of the SDR specially issued for conversion of reserve currency holdings would be a long-term debt or consols to be serviced by the present reserve centres. The rate of interest on the SDRs conversion tranche could of course be lower than the market rate currently paid on dollars and sterling, because an absolute exchange guarantee is attached to SDRs which does not apply to currency holdings. Nevertheless, the present rate on SDRs of $1\frac{1}{2}$ per cent would have to be increased substantially, not only to offer some inducement to conversion during the initial period of voluntary action but also to prevent a deterioration of the financial position of monetary authorities participating in the conversion operation.

Any conversion scheme designed to solve the confidence problem poses a number of questions which have to be answered both on the political and on the technical plane. Let me indicate some of these questions without answering them. First, as interest on the special conversion issue of SDRs will probably be paid by the Fund in SDRs, its total amount (let's say 2.5 billion dollars corresponding to a 5 per cent rate on some 50 billion dollars) might well completely pre-empt the need for normal allocations of SDRs, since greater exchange rate flexibility could require a smaller annual creation of SDRs than the current 3 billion dollars. Second, interest and amortization payments by the present reserve centres to the Fund after consolidation could then be turned over to the IBRD, IDA and/or to regional institutions for development financing. Thirdly,

different kinds of SDRs would coexist: SDRs issued in conversion of currency holdings; SDRs allocated under the present system and (if some suggestions of a deposit of gold to the Fund in exchange for SDRs are accepted) SDRs issued for gold, each having a different rate of interest going progressively downwards from a level not much lower than market rates: it would of course make more sense if there were only one kind of SDRs.

7. - Turning now to the *liquidity problem*, I may point out that my conviction that gold is doomed as a reserve asset has been reinforced by the outcome of the Washington agreement on realignment.

The Washington agreement of March 1968 on the two-tier system, the creation of SDRs, the decrease of the share of gold in total reserves during the last decade, and the diminishing use of gold in the financing of external disequilibria are all factors working towards a gradual demonetization of gold. I might mention in addition the expanding industrial uses of the metal, leading to a situation in which equilibrium between supply and demand of non-monetary gold would command increasingly higher market prices, therefore creating incentives for monetary authorities to sell gold in the free market as soon as a revision of the two-tier agreement would allow it.

Logic is also on the side of demonetization: not only does a monetary instrument not require an intrinsic value, but in the long run such an instrument cannot, at one and the same time, be a commodity having a market price and a reserve asset having a conventional value, each influencing and determining the other.

The Washington agreement of last December is another heavy blow to the reserve function of gold. That agreement confirmed that the U.S. monetary authorities are no longer prepared to buy or sell gold at a fixed price for monetary purposes (paradoxically, by devaluing the dollar, they have in effect agreed to increase the price at which they refuse to deal in gold) and will presumably never resume gold transactions. Other monetary authorities, if not yet reluctant to buy gold, certainly are not willing to sell it for monetary purposes, so that the only official transactions in gold will be those between the International Monetary Fund and its members. For all practical purposes world reserve holdings have been cut down by

some 36 billion dollars buried at Fort Knox and in the vaults of central banks.

My view of future development in this respect is that the process of demonetization of gold is a natural one and need not be encouraged in any way, although the establishment of a conversion or consolidation facility in the Fund substituting SDRs for gold could hasten it.

Natural forces are at work in pushing gold out of the system without the trying controversies that would inevitably accompany a negotiation for a major deliberate reform in this direction. It is sufficient that Art. IV, Sect. 7 of the Fund's Articles of Agreement concerning uniform changes in par values, i.e. a generalized increase in the price of gold, should never be implemented. Anyway, it would not only be impossible to find the required 85 per cent majority but also to explain the reasons for such a change, the future supply of international liquidity being now provided institutionally by the activation of special drawing rights.

In effect, assuming both the exclusion of a generalized price increase for monetary gold and the existence of a rising price trend for commodity gold coupled with a future resumption of convertibility in reserve assets other than gold, the rationale for the maintenance of the 1968 Washington agreement concerning a two-tier system would disappear: I.M.F. members would therefore be bound only by Art. IV, Sect. 2 of the Articles of Agreement, which prohibits them to purchase but allows them to sell gold in the market above the official price. In these conditions a built-in mechanism for the demonetization of gold would therefore be operative, within the present system without any deliberate reform.

8. - I am profoundly convinced that the volume as well as the composition of international liquidity should be progressively brought under international control. The first step in this direction has been the creation of special drawing rights, after a long-drawn-out process of study and negotiation extending between 1964-1968 and their activation in 1969 for the first three-year basic period. The experience so far is very encouraging; the asset has been utilized in an appropriate and prudent way under Fund surveillance not only among members of that organization but also in the relations between them and the organization itself. It is to be hoped that SDRs will succeed in establishing themselves firmly so as to become the major com-

ponent of international reserves and that the anti-SDR feeling, which was gaining ground because of the persistence of large U.S. deficits, will gradually fade away.

A most desirable development in the evolution of this reserve asset would of course be the adoption of a SDR unit without gold content, in which par values would be expressed. However, the recent realignment of currencies has shown that the modification of the par value of the dollar in terms of gold is not a politically difficult operation, as was feared; therefore to adopt a de-golded SDR as the numeraire of the international monetary system in order to give the U.S. the possibility of changing the par value of the dollar without inhibitions is no longer an urgent operation.

In other words, until better times, the system can wait with gold nominally at its head, as a sort of King Log, without major inconveniences. The SDR could continue to have its present gold equivalence, subject to the conditions that the equivalence itself will never change and that the instrument remains a final asset, i.e. an asset not convertible into gold. The expression of par values in terms of SDRs in such conditions would of course be merely a window-dressing operation, albeit a politically useful one, because it would prepare the ground for the adoption of a de-golded SDR as the true numeraire of the system.

Thus, a smooth evolution would be accomplished without the bitter doctrinaire controversies that would characterize a deliberate reform in the same direction. The worshippers of gold will not be driven out of the temple.

Greater relevance for a reform in depth of the international monetary system is to be attached to the reappraisal of some of the provisions concerning SDRs. Whereas the rules concerning the designation and the requirement of the so-called balance-of-payments need for its use, although made more flexible, could be maintained substantially unchanged in order to ensure an orderly circulation of SDRs, the reconstitution provisions and the acceptance obligations might need an extensive overhaul; the same is true of the provisions concerning the interest rate.

Another desirable innovation would consist in linking the creation of SDRs with development financing through the allocation of, let's say, 25 per cent of the global amount to IDA and regional development institutions, which will lend it to LDCs in the form of grants or of cheap long-term loans. Together with the interest

paid by present reserve centres on consolidated currency holdings, this amount would greatly help the lot of LDCs. Even if times are probably not yet ripe for such innovations, which are widely considered as inflationary (and wrongly so, because the traditional process of reserve creation in the form of gold or dollars has been connected directly or indirectly with development finance), these suggestions should continue to be kept on the agenda.

The Second Activation of SDRs

9. - In the very short-term, we shall be faced with the decision on the creation of SDRs for the second basic period.

The first decision to create 9.5 million SDRs for the first 3 year basic period 1970-1972 took into account, among other special considerations, a collective judgment that there was a global need to supplement reserves.

Subsequent events proved that the U.S. balance-of-payments deficit and the market mechanism could create a multiple volume of reserves in the form of dollars: the system was thus flooded with the wrong kind of liquidity. And yet, judged in retrospect, that decision was not wrong: if SDRs had not then been created, the instrument would probably have never been put to the test, as no subsequent activation could be justified, for many years, with the motivation of a general shortage of liquidity. We would not have had at our disposal, in the present crisis, any other fixed point of reference except the waning gold. The SDR would have remained a stillborn child.

The second SDRs activation has to take into account not so much the present volume of liquidity as the long-term need for reserves. The necessity to ensure the smooth continuation of the SDR system should prevail — I hope — over short-term considerations: if SDRs have to become the main reserve currency of the system, supplanting dollar holdings, a second activation, even if in a token amount, cannot be dispensed with. I would suggest a basic period of two years, so as to complete the five years which were scheduled to be the standard basic period in the agreement, and an amount of 1.5 billion each year. A supplementary reason for avoiding a blank basic period would be the need to compensate somewhat

the LDCs for the loss they might have suffered on their dollar holdings following the devaluation of the dollar in terms of both gold and other currencies.

Intra-EEC Monetary Relations

10. - The EEC Council of Ministers will shortly open a major debate on the achievement, by stages, of the economic and monetary union, the creation of which was decided in March 1971. The basis for this debate will be a communication by the Commission dealing with the organization of monetary and financial relations within the Community.

The establishment of new exchange relationships in the form of par values or central rates as well as the temporary widening of the margins of fluctuation of exchange rates to 2.25 per cent on each side of the parity or central rates with the intervention currency, decided by the Group of Ten in Washington on December 18, 1971, have given rise to three problems to be dealt with by the enlarged Community:

(a) the potential swing of 9 per cent of exchange rates between any two EEC currencies, if the use of the dollar as intervention currency were to continue, might affect the competitive position of the countries involved;

(b) the possibility for the EEC countries, given the inconvertibility of the main intervention currency, to accumulate U.S. dollars with no guarantee of being able to convert them into other reserve instruments;

(c) finally, the continuous possibility of speculative inflows of short-term capital similar to those which have taken place during the last few years (although the danger of short-term movements induced by interest-rate differentials would be lessened by the widening of the margins).

In order to solve these three problems the Commission suggests, in addition to a concerted policy to check excessive capital inflows, the establishment of a special monetary regime among members:

These measures would be accompanied by the implementation of the proposals concerning the first stage of the realization of the economic and monetary union: effective coordination of short and

medium-term economic policies, particularly in the field of interest rates; measures designed to facilitate capital mobility within the Community and the creation of a European capital market; setting-up of a policy designed to reduce regional imbalances; intensification of a social policy designed to promote employment as well as the training and resettling of labour forces in member countries.

The establishment of a special monetary regime among members would be mainly characterized by a narrowing down of the margins of fluctuation between any two EEC currencies to a maximum of $2\frac{1}{4}$ per cent on each side of the respective parity or central rate; it would require coordinated interventions on the exchange markets in EEC currencies as well as in dollars, and the early creation of a European monetary cooperation Fund with the object of regulating exchange transactions and opening the way to the use of a European unit in the Community financial transactions.

The Commission's program is a praiseworthy effort to shake the present immobility and set in motion the process of integration. It accepts the principle, laid down in the Werner plan, of the parallelism between unification of economic policies and monetary integration, but in my opinion it does not avert altogether the danger of putting the monetary cart before the economic horse. The experience of the last few years proves that no further progress on coordination (which at present involves little more than consultation and reciprocal information) is possible among Community members without a major modification of the present framework of their political relations. To the extent that this "quality jump" is utopian — and I am told it is — some flexibility has to be accepted in the organization of the regional monetary system in Europe, awaiting the time when the utopia of today becomes the reality of tomorrow. A flexibility which should not be devoid of audacity.

My first suggestion would be that, before setting up a European monetary cooperation Fund, a pool of national reserves be created pragmatically by paying let's say 5 to 10 per cent of individual reserves (or an amount calculated on the basis of quotas to be fixed according to other appropriate criteria) into an account to be opened on the books of an Agent of the pool. Gold, dollars, SDRs and reserve positions in the Fund would make up each national contribution in the same proportion as these components stand in reserves at a specified date; an equal amount of national currency could be added to the individual contribution. In exchange, national mo-

netary authorities would receive EEC units of account to be used — to begin with — in settlements of debts arising from exchange market interventions in European currencies.

I refrain from peering more deeply into the future, but it is clear that the functions of the pool could be expanded into those of a fully-fledged European Fund along the lines I have described elsewhere.³

The advantage of such a simple proposal would be to test immediately the political will to do something instead of merely elaborating, ahead of practical needs and possibilities, rules for a European Fund, which would run the risk of remaining a stillborn child, like other recent experiments.

My second suggestion, aimed at avoiding the danger of accumulating inconvertible dollars, would be the one I mentioned above. EEC countries would abstain from buying dollars on the market, while introducing controls on short-term capital movements and agreeing with the U.S. and other monetary areas on a code of conduct in the field of long-term capital movements so as to prevent any undue deterioration of their competitive trade position.

From a technical point of view, such an organization of monetary relations between the EEC and the U.S. will fit in with the I.M.F. Articles of Agreement if each EEC country undertakes to buy and sell gold freely for the settlement of international transactions. In that case, the U.S. authorities would have the responsibility of supporting the dollar on foreign exchange markets or else they should ask the Fund's permission to remain on a floating basis.

Intra-EEC monetary relations, however, would involve interventions by each national monetary authority in EEC currencies so as to maintain reciprocal exchange rates within the chosen margins of fluctuation, let's say 2.25 per cent on each side of the respective basic parity relationship resulting from the official parity declared to the Fund.

My third suggestion would entail a greater flexibility of par values so as to adjust them by small steps, if necessary in order to compensate for differing economic trends resulting from insufficient coordination of economic policies. I believe that, in the present situation of poor coordination of policies, the maintenance of rigid

³ "The European Economic Community at the crossroads", in *Studies in honour of Thorhild Kristensen*, October 1970.

reciprocal parities would involve greater dangers for EEC members than the introduction of a certain degree of flexibility. I am convinced that the possible inconveniences of flexibility for the common agricultural policy and the trade relationships in general would prove a strong incentive to move forward on the road of unification of policies.

Summary and Conclusions

II. - Summing up the main conclusions, I would say the following:

(a) as long as the dollar remains inconvertible, the problem of adjustment between the U.S. and the EEC would better be solved through the free fluctuation of the dollar vis-à-vis the EEC currencies as a whole, the reciprocal relations of these latter being based on relatively fixed parities. Short-term capital controls and an agreement on a code of conduct for long-term capital movements between great monetary areas would be necessary in order to prevent undesirable investment flows and unwanted changes of the respective competitive positions;

(b) to prepare the ground for a gradual resumption of convertibility of some kind and to ensure a better management of international monetary arrangements, the problem of confidence, i.e. essentially the problem of replacing the dollar as a reserve asset, will have to be solved. SDRs could take up the reserve role of the dollar as well as that of sterling within the framework of a mandatory scheme in which present currency holdings in excess of working balances would become long-term debts or consols to be serviced by present reserve centres. Other methods are not to be excluded;

(c) assuming that the Fund's provision for a uniform change in par values (i.e. for a generalized increase in the price of gold) will never be implemented, and assuming further that the price of commodity gold will rise with a more or less steady trend and that convertibility will be resumed at some future time, gold would be gradually phased out of the system without major deliberate reforms whose negotiation would inevitably be accompanied by bickering and trying controversies;

(d) the adoption of a de-golded SDR as a numeraire of the system would be a most desirable development. Experience has however shown that a modification of the par value of the dollar in terms of gold is not a politically difficult operation; therefore a de-golded SDR is no longer a priority. A reappraisal of the rules concerning the designation, balance-of-payment need, reconstitution, acceptance obligations and allocation of SDRs is of greater relevance;

(e) the need to preserve the SDRs system should be regarded as more important than any short-term considerations such as those concerning the present level of international reserves. The creation of SDRs in a token annual amount of let's say 1.5 billion, to be allocated over a two-year period, would complete the standard basic period of five years and compensate LDCs for the loss they might have suffered as a consequence of the devaluation of the dollar;

(f) practical moves towards the establishment of a special EEC monetary regime should include: the pooling of a small percentage of national reserves as a preparatory step towards the setting up of a European Fund; the free fluctuation of the U.S. dollar on the exchange market of the Community and the introduction of exchange controls for capital movements at the borders of the area; the establishment of stable parity relationships inside the Community, with margins of fluctuation between any two EEC currencies of let's say $2\frac{1}{4}$ per cent on each side of the respective basic parity, and a reasonable flexibility of the parities in order to make up for differing economic trends resulting from insufficient coordination of economic policies.

These are the steps which recent events suggest should be considered as a matter for prompt negotiation.

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