

Sharing the Burden of International Adjustment

1. In an article prepared in July 1972, and published in the December issue of this Review, this writer dealt with the suitability of certain indicators for the purpose of making parity changes; as well as with some technical and policy issues in the use of indicators based on the net foreign asset position of the monetary authorities. He also suggested that, in view of the fact that, at this juncture of the evolution of international economic relations, feelings of national sovereignty still run quite strong, any further erosion of that sovereignty, which the use of objective indicators would entail, be confined to conferring officially to the international community only the power to *initiate a move* designed to lead to the adoption of measures (including parity changes) which should correct an international imbalance.

Discretion, as opposite of automaticity, would, however, still largely prevail over the determination of the most appropriate measures. This would emerge from negotiations within an international forum, particularly where serious payments imbalances were experienced by several countries. This article deals with the following related problem: who should adjust whenever such multiple imbalances arise? Before entering into the subject, however, a brief account should be given of two major documents which have been published in recent months and which deal with the "reform" of the international monetary system and in particular with parity adjustments; namely, the Report of the Executive Directors of the IMF released in September 1972, under the title: *Reform of the International Monetary System*; and *The Annual Report* of the Council of Economic Advisers of the US Government, issued at the end of January 1973, which in Chapter 5 and in a Supplement to that Chapter (Appendix A), includes the US proposal for changes in the system and for par value changes.

2. It is not our intention to give an adequate account of these two documents (hereinafter referred to as the "US document" and the "IMF document"), which would deserve a separate extensive

treatment. The few remarks contained in the following paragraphs will merely give an overall description of the content of those documents and, more particularly, will only highlight those points which permit a comparison with our earlier article and those which are relevant for the main subject of this article.

3. Both documents deal with practically all the major aspects of the international monetary system, including some special problems of the moment (e.g., the large accumulation of assets in US dollars outside the United States); the US document chiefly in the form of positive proposals which encompass, in addition, closely related trade matters; while the IMF document mainly describes different positions and discusses the pros and cons of alternative solutions. It is noteworthy that only two of the three major components of the system (the exchange rate adjustment and the provision of liquidity) are thoroughly discussed, whereas both documents appear implicitly to downgrade the third — the domestic adjustment process — which is either briefly mentioned or politely omitted.^{1,2} This is probably a reflection of the currently prevailing political philosophy that largely governs domestic economic policies, and is paralleled by the absence in either document of any discussion of role to be played by conditional liquidity — a striking reversal from the prominence that domestic adjustment and conditional liquidity had enjoyed during the 1950's and most of the 1960's within the context of IMF operations.³

¹ See US document pp. 119-120. The IMF document states (p. 2): "The elements of the international monetary system that are considered in these separate chapters are closely interrelated. Thus, for example, decisions relating to any new arrangement for the settlement of payments imbalances would depend heavily on the working and prospective future working of the adjustment process, *in particular the exchange rate mechanism*" (our italics).

² It should be mentioned, however, that the statement issued on March 27, 1973 by the Finance Ministers of the Committee of the Twenty, included the following sentence in relation to the objective of a better working of the adjustment process: "The importance of effective domestic policies for balance-of-payment adjustments was underlined".

³ In his volume *The Stand-by Arrangement of the International Monetary Fund* (IMF, Washington, D.C., 1970) Mr. JOSEPH GOLD states (p. 4): "The Articles [of the Fund Statute] are not explicit on the domestic policies which members should follow in order to avoid or terminate balance of payments disequilibria, and the absence of a code that binds countries is felt by some observers to be a deficiency of the present international monetary system. The Fund does much to eliminate this deficiency by developing views on the domestic policies that members should follow and by sponsoring these policies in general pronouncements, consultations with members, and financial transactions and operations".

4. Both documents, in their different styles, advocate an increasing role of SDR.s as reserve assets and a correspondingly diminishing role of gold and foreign exchange reserves. Another similarity is the emphasis placed on the need to find solutions to the problems created by short-term international capital movements which have exerted a destabilizing influence again in recent years. In this connection the IMF document discusses at some length a number of techniques, including the use of "wider margins". The latter is one of the techniques favored by the U.S. document — but we venture to presume that this judgement might be revised after the monetary events which have taken place during the months of February and March of this year. As to the exchange rate system proper, both documents appear to favor a par value system with more "flexibility" (frequency of changes, wider margins), while fluctuating rates are considered useful in particular circumstances as a temporary device. The IMF document does not take a firm position as between the different views of various countries concerning such main aspects as, for instance, who should have the authority to initiate par value changes, the use of indicators, who has the responsibility to introduce parity changes, and the application of sanctions in case of non-compliance with the agreed standards. The US document, on the contrary, contains a specific positive proposal and we shall refer to it in the remainder of this section.

5. By and large the US proposal is in many respects similar to the approach outlined in our preceding article. In spite of the statement (p. 120) that the "postwar international monetary arrangements, . . . , had become untenable", the proposal is characterized as "evolutionary" in that it seeks "to build on existing principles and practices where they have proved useful and have met with international approval" (p. 123). It intends to be a blend of automaticity and discretion; the former would be based on objective criteria such as appropriate indicators, whereas, once the need for corrective action were to become manifest, the country concerned would be left "substantial discretion in determining the composition of those adjustment policies". In addition there would be international consultations to determine the applicability of the objective criteria to particular situations and "to consider exceptional cases in which the rules might be overridden" (p. 163). The objective criteria would consist of

changes in reserve position compared with a "base" level which would have a "normal" course of its own through time. There would be a double band around the trend of the base level: a narrower band which, if exceeded, would signal "warnings", and a larger band which, if exceeded, would create a "strong presumption" that action would be taken. If the reserve position were to remain in the areas between the smaller and larger band the country concerned would be allowed to change its par value by "small" percentage in either direction, without IMF approval. However, whenever a reserve position should fall or rise beyond the limits of the outer bands and persist in that area for a preestablished period of time or longer, sanctions would be applied to the country concerned if it fails to take action to correct the imbalance. Examples of such sanctions are: loss of scheduled SDR allocations in case of both uncorrected deficits and surpluses, refusal to provide credit to a deficit country, and, in the opposite case, authorization to impose taxes against the country concerned (a clause relative to the ill-fated scarce currency clause under Article VII, 3 of the present Articles of Agreement of the IMF), and possibly a tax on the country's excess reserve holdings.

6. A suggestion which we believe is of great importance (as argued in footnote 11 of our previous article) is that officially held balances "could be freely presented to the issuing country for conversion into primary reserve assets with a choice among SDRs, reserve positions in the IMF, and gold to be made by the issuing country" (p. 171). This is broader than the similar, but more circumscribed, facility of the present Article VIII, 4, and certainly broader than the narrow interpretation apparently given of that facility. Lastly, it should be mentioned that the US proposal makes room (pp. 169 and 174) for "supplementary criteria" to be used to assist "the reserve indicators in pointing to adjustment needs". This, however gives the impression of being an after-thought since it is difficult to reconcile the solid faith behind the reserve indicators as evidenced by the proposed quasi-mechanical sequence: reserve excess (or deficiency) — expectation of corrective action — sanctions in case of non action; with the admission of possible need for supplementary criteria to assist the reserve indicator. It should be recognized, in addition, that a brief mention is made of "consultative procedures" (p. 169) which would be inserted in the above mentioned sequence,

presumably after the first step; but the point is not sufficiently developed to grasp the real role of these consultations.

7. The above comments, as well as the whole question of "sanctions", bring us close to the main subject of this article: who should adjust? The IMF document raises this question under the heading "Responsibility for making par value changes"; but it seems more concerned with the effects of alternative approaches on the value of the SDRs in terms of currencies, than with providing adequate answers to the question. What it does, however, is to make the important point that some *external* criterion is needed to determine what is called an "appropriate division of responsibility". It seems indeed difficult to decide on the application of sanctions unless one is in a position to arrive at a determination of responsibilities. This whole question was merely skirted in our previous article where only two extreme cases were mentioned by way of examples, and solutions were offered for them without indication of the principles behind them. It was stated, in particular (paragraph 43), that in the case of multiple imbalances with only one country registering a deficit and experiencing at the same time a price inflation, the whole correction should be made by that country. Where confronted with less extreme cases, however, it was suggested that the solution should emerge from the consultation process, and implicitly from the diagnosis of the causes.

8. The US proposal on the contrary, seems to follow a purely mechanical approach in the sense that it equates symmetry with equity. This is spelled out in pp. 123 and 124 where emphasis is placed on "broadly symmetrical rules and *responsibilities* for taking action to restore equilibrium";⁴ and where more specifically is stressed that, contrary to what has been the practice so far, the US proposal would introduce a symmetrical *discipline* entailing that not only the country which experiences a persistent deterioration in its reserve position, but also the countries gaining reserves should take adjustment measures. It then sums up the supporting considerations by stating "Thus a balanced distribution of responsibility for initiating adjustment is part of a question of equity" (p. 124).⁵ In our view, one thing

⁴ Our italics.

⁵ Equity and equitable sharing of responsibilities are mentioned in the same sense in pp. 162 and 163; although in this section sharing in the adjustment process is also labeled as "effective".

is to make symmetry a test of goodness of an indicator; and another is to take the position that the revelation of the indicator creates responsibilities. These are two distinctly separate things, and to speak of responsibilities a value judgement is necessary. This is particularly so in the case of indicators based on the net foreign asset position of the monetary authorities. As we pointed out in the preceding article (paragraph 31), these indicators take a short cut route by-passing the analysis of the factors (real or monetary, income- or price-induced) creating the imbalance. However, one cannot dispense with that analysis altogether, and in our approach it takes place after the finding of the maladjustment. This cautious attitude is based in particular on the different effects of different policy measures; a point which will be elaborated in a later paragraph.

9. Unfortunately we do not receive much assistance in this task from established economic theory. What we would need is a theory of international trade fully integrated with the monetary theory and with the theories of growth and resources allocation. Except for a few empirical investigations, we only have separate bodies of doctrines each more or less assuming away phenomena which fall in the domain of the others. *Rebus sic stantibus*, we shall content ourselves with "partial" analyses, dealing separately with different hypothetical cases. In addition we shall make a distinction between deficits or surpluses which are traceable to the action of the authorities of the countries concerned; and other imbalances, which may be called exogenous or autonomous. First, let us deal, however, with a purely technical problem.

10. When reserve indicators are used, and regardless of whether a single band or a double band approach is followed, it is presumed that the width of the part below the "base level" is the same as the width of the part above it. In other words the same percentage of accumulation or decline in reserves would be necessary⁶ to trigger the mechanism leading to corrective action. Under these conditions let us suppose that a country experiences a decline in reserves and that a number of other countries experience an accumulation above the base level. If the accumulation is evenly spread among the various surplus countries, the likely outcome is that the decline in reserves in

⁶ From here on the term "reserves" will be used as synonym of net foreign asset position.

the deficit country will cause its net foreign asset position to exceed the lower limit and persist in that situation before any of the countries which accumulate reserves reach the upper limit. If actual developments were to follow this pattern in the large majority of the cases, and if the presumption that action is taken by the surplus countries (with consultation or without them) arises *only when* the upper limit is exceeded, the opportunity for symmetrical action, even under the US proposal, only rarely would arise. One would be tempted to argue that since the reverse case (a single country accumulating reserves at a faster than "normal" rate, and a group of countries experiencing a decline in reserves) is not likely to occur frequently, the width of the band(s) above the base line should be smaller than that of the band(s) below the line. However, as we shall try to show in a later paragraph, this would ultimately risk in practice to penalize the countries that use their resources more effectively, and, on the whole, would tend to reduce efficiency in the use of resources on a world-wide basis.

11. Let us, however, assume that the relative size of the imbalances (positive and negative), as revealed by the reserves movements is approximately the same. Let us also take a few oversimplified cases and assume that the imbalances result from autonomous shifts in world demand functions, which could, in turn, be due to the following hypothetical (but not altogether implausible) causes: (i) a technological progress permitting the substitution of aluminum for copper in electric power transmission at a considerable saving in real terms (and also in money terms for the final users); (ii) the impact of "energy crisis" and pollution control policies on automobile demand, favoring small size engine vehicles and making unattractive large size engine cars; and (iii) a mere change of habits in human food consumption, resulting in a decline in demand for beef and in an increase in demand for lamb, fish and other protein rich natural products. If any of those circumstances were to materialize, a number of countries would be accumulating reserves, while the reserves of a number of other countries would decline. However, with the possible exception of the second case, the bulk of these reserve changes would not result from transactions between the first and the second group of countries. Thus in the aluminum-versus-copper case Chile, Zaire, Zambia may register considerable balance of payments deficits and would have to take action under the rules. It would seem, however, both fruitless and wasteful to expect symmetrical adjustment policies from e.g.

Guyana, Jamaica, Norway, to ease the task of the deficit countries: fruitless because, to obtain a material result, it would probably take, under the circumstances, a larger change in par value than could be reasonably expected. It would be wasteful because to be effective any action would have the objective and the result to disinduce the use of a product which, under the assumption, would entail a saving in real resources. Similar considerations apply to the other cases: no one would solve Argentina's or Uruguay's balance of payments problems by inducing Iceland either to revalue the Krona or to inflate in order to make its fish less competitive at the going exchange rate.

12. Even though the symmetrical sharing of the adjustment burden, between deficit and surplus countries to restore balance appears to be lacking substantive foundation in the cases mentioned above, the question would still have to be examined on its own merits as to what action is expected of surplus countries, under a reserve indicator system, should their reserve position exceed the upper level of the band. There is no doubt that, under the approach we suggested, there should be consultations between the countries concerned and the international agency (IMF). The outcome of the analysis conducted at these consultations could lead to a number of different conclusions and actions. It is conceivable, for instance, that the reserve windfall is of the nature of a quasi-rent which is expected to disappear within a relatively short period of time. In this case it may be expected that the general domestic economic expansion prompted by the large export income is likely to exert pressure on outgoing payments towards a restoration of external balance. This may be facilitated by a relaxation of import restrictions; but, if so, care should be taken to avoid that a "permanent" addition to import demand is built into the balance of payments. Should it be concluded, however, that the reserve accumulation could continue for a relatively longer period of time, adjustment measures are called for. They may differ, however, depending on whether the country concerned is a developed or a less developed one. In the latter case it is important to take into account the impact of the reserve accumulation on the inflow of development financial assistance. In view of the limited amount of resources available to international development institutions and to national authorities as well, it is quite possible that such assistance would no longer be available to a country with (temporarily) plentiful

and rising reserves.⁷ While the pattern of disbursement of project lending may result in some continuation of inflow of financial resources, the impact of a reduction or cessation of loan commitments would be felt a few years hence.⁸ Under those circumstances a currency revaluation or a deliberate economic expansion effort in the absence of a coordinated investment program could be wasteful and damaging in the long run. Some aspects of the currency revaluation solution in the case of a less developed country will be examined in the context of a more special case of countries benefitting from the discovery of natural resources. In the case of developed countries the argument in favor of effective corrective action is much stronger. If the assumed shift in outside demand is so great as to produce a large enough increase in reserves to call for action, there seems to be a presumption in favor of measures for real national product expansion or a stepped up flow of project financing or both. A change in par value may also be appropriate depending, *inter alia*, on the expected duration of the favorable payments situation. In general it is practically impossible to state in advance the particular avenue(s) to be followed in order to bring about a correction. A very important point to bear in mind in this respect is the different *modus operandi* of the various alternatives. While a domestic expansion is expected to bring about an income induced demand for foreign goods and services, a revaluation would remove certain firms or groups of firms (composing an entire industry) from the export market, and could thus lead to a reorientation of the domestic economic structure according to comparative advantages (assuming that the vested interests would not resist this). This may be advisable from the point of view of the efficiency in the use of resources on a world-wide basis, but its effectiveness would also depend on the action taken by the deficit countries. It would, however, seem preferable to a domestic expansion whenever the economy of the country concerned already experienced a general demand pressure; for, under these circumstances the main effect of such an action would be an upward push on prices and wages which, *prima facie*, would seem undesirable.⁹

⁷ Changes in financial assistance flows from international and national sources would take place in a coordinate fashion whenever there existed a Consortium or Consultative Group for that purpose operated under the IBRD or OECD or other entity.

⁸ The experience of Zambia under rising copper prices is instructive in this respect (although the price rise was not due to shifts in demand functions).

⁹ This point will be further developed in a later paragraph.

13. It was stated above that in cases where the origin of the imbalances is a shift in demand functions due to exogenous factors, the appropriateness of alternative corrective actions by surplus countries depended also on the corrective policies followed by the deficit countries. In our hypothetical example of a shift in preferences towards small size engine automobiles, the countries which, *ceteris paribus*, might experience a decline in reserves would be the US and Canada. One of the reactions of the automotive industries in these countries could be to convert to the production of the type of vehicles in high demand. Should this be the case, the time necessary for this operation may be relatively short, and thus the countries' deficits could be of such a short duration as to make it inadvisable for them to devalue their currencies. Likewise it may be inadvisable for the surplus countries to penalize their *other* export and import-competing industries through a revaluation. Temporary trade measures may be preferable for both sides. Should the automotive industries decide, however, to confine their operations to large luxury cars more penetrating measures on both sides may have to be considered. In the other two hypothetical cases involving primary products, the corrective action of the deficit countries is not likely to be the same as that of a developed country. The speed of an industrial conversion will probably be much lower due to a number of circumstances that are likely to exist in a developing country, such as the need to start anew with a different economic activity capable of producing export income, the insufficiency of infrastructures for that purpose, the difficulties in obtaining promptly financial assistance to carry out the needed investments, the limited availability of technological know-how, and so forth. Whatever the solution, it remains true that, as stated earlier, none of these problems is bound to be solved by symmetrical action by the surplus countries.

14. Before focussing our attention on the cases of expansionary and contractionary impulses transmitted directly between developed countries, it is necessary to consider briefly a special case typified by the major oil producing countries, particularly during the initial phase of the exploitation of new fields.¹⁰ It has been a common occurrence in cases of this type that the countries concerned have accumulated

¹⁰ The general case is that of rapidly rising income from royalties for the exploitation or use of existing natural resources.

foreign assets at a rapid rate. Under a reserve indicator system this would have caused them to exceed the upper limit of the band of the foreign asset position, while no other country would have shown probably a reserve decline of such a magnitude as to call for corrective action. The main reason for this is that the importers of the newly found oil (mainly developed countries) would merely change the source of supply. The question to raise is: should there be a correction on the part of the exporting country? If the correction were to be in the form of a change in par value this would mean an appreciation; but on substantive considerations this would appear to be unwarranted. Though this matter deserves much more extensive examination, it should be realized that the very likely absence of entrepreneurial abilities, technical skills, infrastructural facilities in these countries, coupled with a more liberal import policy which they are likely to follow, would tend to reduce or eliminate primary and secondary productive activities even at the existing exchange rate: the freely available imports would be cheaper or better, or both, than the domestic products. No doubt the national income accountants would produce rising figures for the GNP, but it is likely that the diversification (development) of the country's economy would suffer. Should its currency be appreciated the mentioned effects would be even more pronounced. In principle, an appropriate alternative would seem to be a vigorous domestic public investment program; but in the countries under consideration this course of action is likely to find obstacles in the limited administrative capacity and limited endowment of other factors of production as already noted.

15. We shall now discuss the case which is probably prominent in most writers' mind; namely, the case where accumulation and declines in reserves are due to different rates of monetary expansion which are controlled or controllable by the monetary authorities. We make the additional assumption that the changes in reserves reflect transactions between the countries concerned; which, to simplify matters further, we assume to be only current transactions. Under a system of readjustable parities, the first question to be asked is: what are the implications of the different methods for reestablishing balance? More specifically, if the adjustment is sought via parity changes, what are the implications of various combinations of changes,

up or down, of the parities of different currencies?¹¹ A similar question arises when the adjustment is sought via modifications of the relative rates of change of such aggregates as the national income or the average price level". Raising these questions means implicitly that merely aiming at the elimination (or substantial reduction) of imbalances in external accounts is a necessary but not a sufficient objective. If this is accepted as a legitimate position, as we do, it follows that one needs external, non-accounting criteria, or put differently, a value judgement, as a guidance to devise solutions. Our contention is based on the following set of considerations.

16. If it were true that changes in any aggregate are accompanied by proportionate changes in each and all of the components, then there would be equivalence between the various possible methods of sharing the adjustment burden between deficit and surplus countries. This seems to be the unstated assumption behind the pure symmetry proposal.¹² In fact, however, the various components do not change proportionately: a change in the price level attributable to monetary expansion is usually accompanied by changes in relative prices; a par value change does not affect equally the various domestic productive units and individual money incomes, nor does it affect equally all exports; a deliberate upward push of gross national output does not result in a parallel expansion of the different productive units; nor does it result in uniform movements along assumedly stable individual consumption functions; nor, alternatively, in uniform upward shifts in assumedly non-stable individual consumption functions. Because of these non-uniformities in the effects of corrective policy actions, and as long as we deal with independent and separate national units, agreed guidelines are needed for the correction of imbalances which are attributable to policy action (or non-action) by one or more countries. It is proposed that among the various possible criteria to judge alternative corrective actions, the following should be given higher ranking: the efficient use of economic resources; the minimization of unintended redistributive effects; and the preservation of national sovereignty in the conduct of economic and financial policies.

¹¹ As the IMF document observes, there is certainly a difference insofar as the value of the standard is concerned when expressed in terms of the currencies involved, taken together. This aspect is, however, closer to the liquidity problem than to ours.

¹² It must be said in fairness that the unfortunate cleavage between macro- and micro-economics produced by the *General Theory* and still largely with us almost forty years later, is partly behind this oversimplified assumption.

17. To arrive at positive conclusions which are operationally useful, further consideration is necessary of some typical sequences which normally take place when international imbalances of the type under consideration arise. Let us assume that the primary cause of a decline in reserves in country A is a general monetary and financial policy which leads to pressures on both domestic resources (price increases) and foreign assets. Let us further assume that the intensity of the latter pressure is such that after having caused A's reserves to fall below the low level of the band, it causes the reserves of countries B, C, and D to exceed their higher point after a lag of few months.¹³ Under these assumptions A's relative prices are likely to change, and the changing rate of profitability in different activities is likely to affect adversely the efficiency in the use of resources. The loss depends *inter alia* on the duration of the excessive expansionary process, on the time pattern of its transmission at home and abroad, and on the expectation as to its duration. If pressure is first exerted on domestic resources some investment yielding quick return may be made, which eventually will prove to be wasteful; while possible expectations that in the longer run "price stability" or a given low rate of price change will be reestablished may affect the flow of resources in the short-term and long-term financial markets, as well as the respective interest rates, and thus the type of investments financed by those flows. Equally important, however, are the possible effects on B, C and D. The increase in demand for goods exported to A will probably induce producers in the first instance to expand output with existing plants almost certainly at rising marginal and unit costs. Other producing units may be affected, however, either because of pressures on factor markets caused by the exporting firms, or by whatever monetary expansion is allowed by the authorities as a consequence of the rise in reserves. However, with the presumption that under the new system adjustments are made frequently, few investments are probably made in the initial phase in response to the assumed higher foreign demand. Therefore if a correction is promptly made by A no major dislocation will take place in B, C and D.

18. Let us now assume, however, that countries B, C and D take deliberate action to correct the imbalances caused by the excessive monetary expansion in A, and let us examine very rapidly some

¹³ If the lag is much longer A is the only country which may have to take corrective action, and thus no problem of adjustment sharing arises.

possible consequences of this action. If the proposed correction takes the form of an upward change in par values, the following effects may be expected: those export firms which sold their output to a number of countries (and not only to A) and whose marginal and average unit costs approximately equalled foreign prices before the revaluation, would find themselves excluded from the export market. The same would apply to firms which, though operating with larger profit margins, would find that the after revaluation foreign price (expressed in domestic currency) would no longer be remunerative. Likewise productive units which compete with imports (including imports from countries other than A) may find themselves displaced by foreign firms. To the extent that these phenomena take place, they would cause a reallocation of factors of production, including phenomena of unemployment, and consequent income redistribution. If the proposed correction is a monetary expansion which would aim at raising prices and money costs, the effects of this solution would be commensurate to the changes in relative prices that it would cause. In particular, there would be a redistribution of income and wealth, some waste of resources in case quick-return investments are made while prices increase unevenly; and possibly transitional unemployment. Furthermore, from the point of view of the national governments of B, C, and D., it should be noted that they would be forced to follow any of the alternative courses of action mentioned above solely because the government of A, for its own internal reasons, adopted an expansionary policy. On the whole, and perhaps more fundamentally, the point should be made that since by assumption only monetary phenomena are taking place, (e.g., no changes in production or consumption functions), one should expect that after all the effects of the corrective actions have worked themselves out the relative positions of the various economic units in the countries concerned, as well as factors allocations and remunerations in real terms, will be the same as they were before the disturbance occurred. In the interim, however, due to the uneven pattern of propagations of changes, there would be resources misallocations and temporary forced income redistributions; and it would seem therefore reasonable to try to reduce to a minimum these temporary adverse effects.

19. A further point seems to emerge from these considerations. The pattern of behavior of the large majority of individuals, at least in developed market economies, seems to be based upon the expectation

that a certain "norm" will prevail in the future trend of prices, including interest rates. Nobody today (April 1973) would purchase new long term bond issues in the United States yielding 7.5-8.5 per cent if the expectations that prices ten, fifteen years hence would increase at a rate of, say twenty per cent per year. In fact the strongest deterrent against any purchase would be not so much an expected high rate of price increase in the future, but an expectation of indeterminacy. Indeed, it would seem that even the concept underlying an international monetary system based on fixed (though adjustable) par values, as well as the notion of corrective action, is a certain norm of monetary behavior. Thus, in addition to the minimization of economic dislocations, of unwanted income redistribution and of infringement of national sovereignty, a guideline to determine where the burden of adjustment falls should be an internationally agreed norm as to monetary and financial behavior. A country that should depart from whatever is the agreed standard is expected to return to it within a relatively short period of time. If this does not happen, and if the reserve indicator gives the warning signal, *the presumption* is that it will take corrective action, on the grounds that to expect action from other countries would entail in most cases not only a forced departure from the standard, but more importantly, would produce the other adverse consequences mentioned above.

20. The opposite case, of an implausible deliberate deflationary policy, would nowadays have only an academic interest. A less unrealistic one would consist of a rapid increase in productivity in country A not matched by a corresponding increase in wages. In other countries productivity would assumedly not change while prices (and wages) would change at a rate approximately equal to the agreed standard.¹⁴ This case is not strictly comparable with the preceding one since there are supposedly changes in production functions which, in addition, are not normally uniform throughout the economy. Under these assumptions country A would accumulate reserves since its prices would be stable or even decline; and *in addition* its comparative advantage vis-à-vis other countries would change in certain lines of

¹⁴ J.M. Keynes dealt with a similar case in one of his latest writings (see his "The objective of international price stability" in *The Economic Journal*, June-September 1943) and concluded in favor of changes in par values. See also our "Il Concetto di 'Squilibrio Fondamentale' e le sue Applicazioni Pratiche", in *Giornale degli Economisti e Annali di Economia*, November-December 1947.

production. It would appear that in these circumstances economic dislocations and other effects of corrective actions would be minimized if the corrections were made by A rather than by its partners.

21. Reality, of course, does not conform to any of the single patterns outlined in the preceding paragraphs. Actual cases may offer a mix of general price changes, shifts in demand and supply functions, different rates of change in productivity/wage rates relations and so forth. Furthermore, it is too much to presume that the majority of the countries strictly adheres to the agreed upon rules of behavior. This reduces, though does not eliminate, the strength of the presumptions stated above, and stresses once again the need for a careful diagnosis of the causes of the imbalances before reaching a decision as to whether unilateral corrective action is appropriate, or whether it is desirable that more than one country act in a coordinated manner to restore balance.

22. The conclusions of the preceding paragraphs as to the applicability of rules of symmetrical correction may be summarized as follows. They apply to the use of reserve indicators implemented through a band straddling over a "basic line" of reserve movements. (i) Where a country's accumulation (decline) of reserves is such that corrective action on its part is called for, it is possible that no other country experiencing a decline (accumulation) in reserves reaches the outer limit of the band. Thus, no symmetrical action is required in this case. (ii) Countries, particularly primary producing countries, may experience imbalances in opposite directions due to demand shifts elsewhere in the world. In such cases, even if the outer limits of the bands are reached, there seems to be little merit in requiring surplus countries to take action *in order to facilitate the task* of the deficit countries. Even where action is taken by them because of its own merits, this would not be in compliance with an "equity" principle to share the burden of adjustment. (iii) Special cases (e.g., oil countries, and also countries experiencing a dramatic improvement in terms of trade) may have to be treated with *ad hoc* rules, particularly where developing countries are involved. (iv) Whenever individual identifiable factors significantly affect the trade transactions between countries, particularly developed countries, the advisability of unilateral or multilateral (symmetrical) action depends on such elements as the duration of changes to be made in industrial set up, the amount of

financial resources required to carry them out, and so forth. A concerted action requires a high degree of international collaboration and understanding in matters which go beyond the financial, monetary and exchange rate fields being considered by the reform of the international monetary system. (v) Whenever the imbalances can be attributed to changes in national aggregates, including the price level, any decision as to who takes action requires a prior agreement on certain standards of behavior, as well as on the criteria to be followed in judging the consequences of certain corrective actions (e.g., effective use of resources, extent of income and wealth redistribution, etc). (vi) On the basis of the criteria just mentioned, it appears that whenever a country deviates from the agreed standards in following a policy of excessive monetary expansion, the *presumption* is that it behooves to it to take corrective action. Similarly, a country with a persistent surplus attributable to changes in productivity faster, relative to wage rate changes, than in other countries is *presumed* to be the one that takes corrective action. (vii) In practice cases cannot always be so univocally classified because a set of causes may be operative at the same time. In these complex cases, and where the imbalances appear to be interrelated, the findings as to the basic causes determine the scope of multilateral action.

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