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monetary gold stock of the world. After the spectacle of the last twelve months, it will be difficult to accept the idea that the supply of reserves to the world should depend on the ups and downs of private gold speculation and on the above-mentioned non-speculative factors. With the approval of the Special Drawing Rights scheme the principle has been accepted that the provision of global monetary reserves should be deliberately managed—by analogy with the deliberate management of the domestic money supply.

Gold Cannot Be Replaced

Nevertheless gold cannot be easily dispensed with in the present monetary system. Monetary gold stocks are still by far the most important part of the world's monetary reserves, accounting for nearly three fifths of the total; nobody can be interested in depreciating this block of reserves worth roughly \$40 billion. Gold is the common measure for fixing the relationships between currencies

within the IMF and it is also to be the measure for the new Special Drawing Rights vis-à-vis national currencies. The present gold exchange standard, despite its imperfections, is still preferable to a system without gold. The commitment, inherent in the gold exchange standard, to convert the key currency on request into gold is a means, albeit an imperfect one, of imposing some monetary discipline. Were gold to be removed from its present universal role the world economy would either have to fall back on a pure foreign exchange standard, i.e. a pure dollar standard, or it would disintegrate into several currency blocs.

The gold pool countries' decision of March 1968 to withdraw from the free gold market was taken under the pressure of a concrete critical situation. The additional decision, however, not to expect any significant reserve contribution from gold in the future demonstrates that a further step was taken in the direction of detaching our system from an irrational gold

myth. The Italian central bank expressed this idea in its latest Annual Report in the following way: "The Washington decisions ... form part of the evolutionary process which has reduced the monetary functions of gold, first inside countries and then internationally".

In this sense, the separation of the commercial from the official gold price may be considered a landmark in the process of gradually diminishing the role of gold. But the repercussions of this price splitting on the evolution of the world economy should not be overrated. In this respect the setting free of the commercial gold market is likely to be of only secondary importance. For the stability of the world economy in the period ahead, the development of the American balance of payments and of confidence in the dollar are of far greater importance than the ups and downs of the commercial gold price, notwithstanding the widespread publicity which the latter have received up till now.

SDR Will Rationalise the World's Currency System

by Dr Wilhelm Hankel, Bonn

A few months of an unseasonably torrid spring and summer scorching the world of international currencies have been sufficient to revise judgment upon the Special Drawing Rights (SDR) in their intended function as a new reserve instrument. It is not very long ago that most commentators looked down their noses at this new child of eager consultations and discussions, giving it the slightly abusive name of "paper gold", or suspecting it to be a more or less inflationary homunculus bred in the monetary alchemists' retort whose "native hue of resolution is sicklied o'er with the pale cast of thought", but there is hardly an expert left today, and none of the people bearing actual responsibility, who had not, in the thick of the monetary battles, longed for the arrival

of SDR openly or secretly, quite as keenly as the Duke of Wellington longed for the Prussians' arrival on the hills of Waterloo.

A Constructive New Development

Special Drawing Rights, as they exist today, have been developed by gradual steps at successive currency conferences at The Hague (June 25, 1966), Luxembourg (September 12, '66), Munich (April 17, '67), London (August 26, '67), Rio de Janeiro (September 25, '67), and Stockholm (March 29 and 30, '68). Work on them was started at a time when people had long realised the many weak spots of the traditional gold currency standard but when, in the absence of an actual crisis, distant sheet-lightning produced the misleading feeling that

there was still much time left for a "true" reform of the system. Only when the storm broke, it became possible, in the light of its thunder-flashes, to recognise the truly constructive value of the new design.

What is the new system all about? Special Drawing Rights may transform the present currency system, which is based on dollar and gold holdings, into a multi-currency standard using as its basis all the most important national currencies, but they need not do it. Using SDR, countries will in future be entitled to draw any required currency directly against another one, which means that currencies will become directly convertible at fixed rates of exchange. Looking at SDR from this angle, and in the long term, they

can be interpreted as a dynamic or, better expressed, evolutionary potentiality in the formation of currency reserves.

Gold Has Not Lost Its Throne

Whether SDR will be used, and to what extent, depends on the growth of dollar and gold reserves. There is no doubt that their growth will continue but the rate of growth may be severely cut, for since the governors of the central banks took their famous decision at Washington on March 16, 1968, any further influx of reserve gold into the currency system has been restricted and will be strictly controlled. The Seven of Washington have then resolved:

□ not—as the popular saying was—to “split” the gold market but to divest the dollar partly of its convertibility into gold—it has remained convertible in this sense only between central banks;

□ not to feel compelled to make the central banks undertake technical intervention in the gold market automatically;

□ not to pay out gold, from now on, but also—and this was emphasised at least as strongly—not to buy bullion “at any price” any more.

It is wrong to believe that these decisions are equivalent to a demonetisation of gold — this is not yet the case to date. Gold has not been pushed off its throne, but to remain in the metaphor: from having been an absolute monarch, with unrestricted powers in the field of currencies, gold has now become a ruler hemmed in by a “constitution”. Gold continues to reign, but under precisely defined conditions. It will still be possible to move gold freely from one central bank to another but it can no longer be “lost” from, or leave, this circulation. Under certain conditions, on the other hand, additional gold will be permitted to enter the monetary system but, as indicated, under conditions laid down and supervised by the central banks.

More than seventy central banks have declared their adhesion to this agreement, which has made the

bullion element in the international currency system independent of price changes and thus immune to speculative influences. Whatever may happen in future in the gold markets, the central banks may react to developments there, but they will no longer be compelled to do so — they have thus got rid of the imperative need to intervene. The new constellation will prevent any further dramatic price fluctuations of gold. The price of gold will henceforth tend to remain stable. Under unfavourable circumstances it may decline but it will hardly rise vigorously.

Elastic Growth of Reserves

Not only the quantities of gold held and the price of gold will, from now on, be subject to growth control; it may also be anticipated that dollar reserves will cease to grow excessively. At the present time, only the following alternative is conceivable:

□ The United States succeeds in quickly reducing the massive deficits which vitiate especially the US balance of payments. In this case, further growth of dollar reserves will slow down considerably. Increasing reserves will no longer be needed because, if the US succeeds in reducing its deficit, this will also lead to declining dollar surpluses in the hands of dollar holders, and reserve requirements will drop;

□ Or, in spite of all restrictions and adjustments introduced by the US Federal Administration, the deficit of the US balance of payments cannot be appreciably reduced in the foreseeable future. This would induce many central banks outside the United States to seek increased conversion of their dollar holdings into gold. The federal authorities must be aware of this risk at least since March 16, 1968. In place of a continued rise in the size of foreign dollar reserves, the US Treasury would lose increasing amounts of gold — as a signal that the United States is overdrawn on its currency credits, and possibly also as a symptom that world liquidity might be subject to a deflationary trend, because converting US dollars into gold from the US Treasury vaults

will not lead to a growth of reserves abroad.

In other words: the rates of growth of the world currency reserves, of international liquidity, and of SDR are tied to each other, but indirectly, for the volume of the new reserve instrument will only rise in so far as the older reserve instruments, the holdings of gold and dollars, fail to grow sufficiently. The new system is self-adjusting, and its adjustments are triggered off by the growth rates of conventional reserve instruments; its total reserve volume grows gradually and with great flexibility. This may lead to a reduction in the significance of the older reserve instruments, but this reduction will not be inevitable, though it is not impossible that the older forms of reserve formation may eventually, in the far distant future, be reduced to a mere book-keeping entry to remind people of their former importance.

Clear Arrangements

How will SDR be issued? It is the International Monetary Fund which makes them available after having initiated a carefully balanced procedure for preparing a decision on SDR. To make the allocation of SDR valid, 85 per cent of all the votes of central bank governors sitting on the IMF must express their approval. Among the 85 per cent must be all the votes of the European Economic Community, whose members, with their 17 per cent of governors' votes, thus wield a collective right of veto. Moreover, any motion asking for the approval of SDR to be issued may be introduced only by formal proposal of the IMF managing director who is considered to be a “neutral expert” adjudging any application for SDR on its objective and factual merits. It goes without saying that the IMF's future role will become even more important as it has become the banking house of the central banks. Incidentally, it is interesting that it was the Stockholm conference which hardened the strictness of regulations governing the issue of

SDR, in three important points. From the date of that meeting, it has become an established rule that:

□ drawing rights may only be acquired and held by governments, central banks, and international institutions having functions similar to those of central banks. In this way, every kind of illusion about an alleged multi-purpose character of these credits has been scotched, especially the hopes cherished by certain members of the US Congress that SDR might, among other things, be utilised as instruments of development aid;

□ drawing rights may be used exclusively for such transactions as have been clearly defined by the fundamental agreement of Rio de Janeiro. This again is a flat denial of all the notions, which had been rife, that SDR might attract, at a later date, additional functions, e.g. that of an international monetary unit, or be used for the consolidation of short-term currency debts, of which the most famous example are the sterling balances. It has now become clear that different solutions must be sought for this important problem.

□ drawing rights will not be admitted as a surrogate for gold deposits in cases of the IMF in-

creasing the members' gold quotas. This makes it equally clear that the ideas circulating of bullion payments which become due to the IMF being replaced by SDR are fallacies.

It has been the Stockholm meeting which made of SDR increasingly both an instrument of international clearing between national balances of payment, and of an all-sided increase of liquidity, but also of international monetary discipline. All earlier suggestions that SDR are a form of special credits to be extended to countries with a weak currency have been shown up as absurd. But it is of equal importance that the decision of the Stockholm conference to increase the credit factor contained in SDR makes it incumbent on all the members of the IMF to secure a much higher degree of adapting their balances of payments to the requirements of universal equilibrium. In this way, SDR have become an antidote against the ever-present dangers of contamination by inflation to which every country taking part in international trade is exposed. The new instrument of international payments has the double function of both making exchanges more dynamic and more stable.

To sum up: SDR have a double rationalisation effect upon the international currency system — on the one hand, they present a practicable alternative to the "monopoly" of national reserve instruments, whereby the latter are exposed to the rigours of competition. Unless these national reserve currencies prove their value better than in the past, these old reserve instruments, which transformed every national crisis immediately into an international one (a weakness which can also be charged against gold, because its sensitivity to speculative influences had a similarly adverse effect), will gradually be replaced by an international "reserve currency" that owns the advantage of being stable. The use of a stable instrument will at last enable the central banks to supply sufficient liquidity for the actual needs of world trade and international payments, independently of accidental deficits of individual balances of payments of any country, and of the decisions made by the big gold producers. SDR will make it possible to gain two highly desirable blessings, of which the world has stood in need for a long time, namely: more freedom in a more orderly system of supplying the liquidity needed by the world.

EEC in Need of a Currency Union

by Dr h c Alwin Münchmeyer, Hamburg

When the European Customs Union came into operation on July 1, 1968, this has hardly roused any enthusiasm in the Federal Republic of Germany or elsewhere, as people treated the new step almost as a matter of course. The event, moreover, lay under the shadow of the French crisis, the consequences of which for European integration cannot yet be fully assessed even today. In spite of thus coming in not with a bang but with scarcely a whimper, the customs union may be judged, by people of the future, as an impor-

tant historical step. It represents a new and significant advance towards a European Economic Union as stipulated for in the Treaty on the European Economic Community.

Past the Point of No Return

Not only customs duties and physical import controls have been abolished "as a matter of principle" but also labour can circulate with almost complete freedom throughout the Community area. Progress has also been achieved in other fields. It is of great impor-

tance that the EEC countries succeeded in developing a common European policy on farm produce, though its actual rules and regulations cannot yet be considered to be completely satisfactory. However, its deeply entrenched institutions have now become the strongest bracket keeping the European Economic Community together. After the numerous alarms and crises of recent years, it may well be stated now that the point of no return has been passed by the Community. Economic integration of Europe will continue to