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Monetary Experts in the Dark

After a series of unsuccessful bilateral and multilateral conferences there is little hope that the international monetary crisis induced by President Nixon's economic "New Deal" will be overcome in the near future. This became even more obvious after the members of the Group of Ten, which met in London on September 15 and 16, could not agree on a solution because of the different standpoints of the USA and the other nine partners.

Although both antagonists are in favour of a quick return to fixed exchange rates and of a continuous substitution of special drawing rights (SDRs) for the dollar as the leading reserve currency, the international realignment of exchange rates remains the controversial issue. While the USA refuses to devalue the dollar but demands a revaluation of the other important currencies, the remaining members of the Group of Ten advocate a dollar devaluation. They are ready to revalue certain currencies if the USA abolishes the supplementary tax on imports. But according to the American Secretary of Treasury, Mr Connally, this is completely out of the question.

It is therefore not surprising that observers under these circumstances see virtually no chance for a compromise to be reached during the International Monetary Fund (IMF) meeting between September 27 and October 1 in Washington. But even assuming that realignment does take place later on, will the exchange rates that look right at that moment also remain right in the future?

IMF is realistic enough to doubt this. It therefore demanded in its annual report that realignment must be followed by the pooling of all nations' foreign exchange reserves. However, the road towards the establishment of a World Reserve Bank—as the ultimate aim—will be paved with many problems. The struggle of the six EEC-member countries over the pooling of their foreign exchange reserves has shown the difficulties of such a task clearly. How many more obstacles must be overcome by the IMF-family in order to agree upon the same matter!

Most monetary experts, on the other hand, believe that floating is the only long-term monetary solution. In their view people will—contrary to the old prophecy—continue to hold "unsecure" reserve assets such as dollars in the floating system, because they have no incentive to depose of fixed price dollars at moments of crisis. Furthermore, the argument often brought forward that long-term investments and industrial decisions regarding international trade and development would be more difficult in a system of floating exchange rates than in the regime of fixed parities does in their opinion not hold true, since nobody can predict for how long the fixed rates will remain stable. And regarding the slight reduction in world liquidity which would take place due to the fall in value of dollar reserves, this could easily be compensated by a rise in SDRs. The fact that exchange rates of nearly all major currencies have been floating since August 23, and that Canada went through the floating experience from 1951 to 1962 without the predicted chaos taking place is further proof for the experts that this system is the best.

However, it is often overlooked that during the last weeks all floating exchange rates—including the DM, which up to September 22 was the only prominent exception—have been manipulated, the aim of the Reserve Banks being the achievement of a relatively stable exchange value. If this would continue, more flexibility would hardly be achieved by floating. A study of the Canadian era of floating also proves that this system was only efficient as long as the Government did not manipulate the free development of the exchange rate.

The official introduction of floating would therefore have to be accompanied by a prohibition of state manipulation. But which institution should take the responsibility of supervising the free market development of exchange rates and which sanctions should be imposed on a country found guilty of manipulations? These and many other questions remain to be answered by the advocates of floating. They show that monetary experts haven't yet left the stage of groping in the dark.

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