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Aftermath of the IMF-Meeting

Interview with Dr Otmar Emminger, Deputy Governor of the Deutsche Bundesbank

Dr Emminger, what are according to your opinion the main results of the Annual Meeting of the IMF in Washington?

Two subjects dominated the discussion: *first*, how to reach as quickly as possible the necessary payments equilibrium between the United States and the rest of the world, with a view to attaining realistic exchange rates and the abolition of the American import surcharge and other trade impediments; *second*, what should be the main lines of reform in order to put the international monetary system on a sound footing in the longer run.

Change of Climate

With respect to the first goal we have progressed from the phase of confrontation between the United States and the other industrial countries—a confrontation which characterised the London Conference of the Group of Ten in the middle of September—to the phase of co-operation and negotiation. The work program for these negotiations was agreed upon and a preliminary time-table laid down. It has been recognised and accepted by all concerned that the necessary large adjustment in relative trade and payments positions cannot be brought

about without a general realignment of parities. It has also been recognised by all, including also the Americans, that it would be dangerous to let the present uncertainties in world trade and payments drag on for too long.

There was such a change of climate during the Annual Meeting from deep gloom to a certain euphoria that near the end of the Meeting the American Secretary of the Treasury, Mr Connally, had to warn that we should “not mistake progress in understanding and agreement on procedures for the hard policy decisions necessary for a satisfactory solution. Much difficult work remains . . .”.

On the longer-run problem of international monetary reform there was a consensus that the crisis should be taken as a unique opportunity for improving the system. On several points, such as more exchange-rate flexibility and an increased role for Special Drawing Rights, there appeared a surprisingly large measure of agreement.

Regarding the first goal, one can say that opinions on the best way towards a realignment of parities still differ widely. The US wants an upvaluation of other currencies in relation to the dollar, while the EEC countries and Japan plead for a devalua-

tion of the dollar. Do you see the possibility of a compromise?

The contrast between the two views has not been so sharp as is implied in your question. The EEC countries and Japan have not asked the US to accomplish the whole of the required adjustment by devaluing the dollar; they—and, by the way, also Britain—have only asked that the United States *contributes* also on its side some part of the adjustment in exchange rates (“sharing of the burden”). This would mean that the dollar devalues to a moderate extent, that some other currencies, like the yen, the D-mark, the Canadian dollar and a few others, would upvalue their gold parity, and that a number of other currencies, e.g. the French franc, would remain at their present gold parities. The main task before the Group of Ten is to reach agreement on the *relative shift* between the dollar and other currencies. A moderate devaluation of the dollar would probably expedite the process of negotiation and would also help achieve a better result in substance. Why should the Americans not utilise this useful negotiating instrument?

With respect to the long-term problems of international monetary reform, some experts have

proposed a widening of the margins to a band of ± 2 to ± 5 p.c. on both sides of the par values. Would this be sufficient to assure adequate flexibility of the international monetary system?

What one can realistically expect from the present effort at reform is a widening of the margins up to ± 3 p.c. (instead of the previous ± 1 p.c.). In addition, it is likely that the IMF will be authorised to permit, under certain conditions, a temporary wider float in order to facilitate the transition to a new parity or the defense against very large disruptive capital flows. In my view this is the most that would still be compatible with a system of fundamentally stable parity relations. Of course, this would not entirely satisfy those academic economists who plead for complete and limitless flexibility all round.

Future Role of the Dollar

There appears to be a consensus that in the longer run the dollar should be supplanted as a "key currency" by Special Drawing Rights. How fast should or could this be achieved?

I fear there is a misunderstanding involved here. I don't think that the dollar will be supplanted so easily as a "key currency". The dollar has not become a "key currency" through the Bretton Woods Agreement. Key currencies cannot be made by legal fiat, they develop by the force of economic circumstances. The dollar will probably remain for quite some time the chief *transaction* and *intervention* currency of the world. If it should one day be supplanted in that capacity, it will not be by Special Drawing Rights, for they cannot be used in commercial transactions and market intervention, but by some other currency.

What is at stake, is the role of the dollar as an instrument of

reserve creation. The aim should be to limit—or eliminate—the uncontrolled creation of reserves through accumulation of dollars and other national reserve currencies. The future growth of reserves in the world should be entrusted—entirely or principally—to Special Drawing Rights which are under international control. This had been the idea underlying the Special Drawing Rights right from the beginning (as witness the first report of the Group of Ten on this problem in 1966). As events have shown, it can, however, not be attained without a general agreement to the effect that in future countries will hold reserves in the form of foreign exchange only in strictly limited amounts as working balances. This is easy to demand, but difficult to achieve (and to police) in practice. It presupposes also that there is an agreed way for converting excess dollars accruing from market intervention into Special Drawing Rights (or other agreed international reserve assets).

SDRs and Development Aid

Is there a danger that the introduction of Special Drawing Rights as a new reserve asset will increase international liquidity to an inappropriate degree?

Special Drawing Rights have been introduced a few years ago on the explicit assumption that reserve creation via the accumulation of reserve currencies would dwindle or disappear altogether. This assumption has up to now come true — and here lies the real problem of excessive reserve creation. Currency reserves in the world have expanded by more than \$ 32 bn in 1970/71 through increases in foreign exchange reserves. Compared to this, an annual SDR allocation of \$ 3 or 3.5 bn is a minor affair. If we really succeed in stopping re-

serve creation through the accumulation of dollars and other national currencies (and absorb the excess creation of 1970/71), controlling and restraining the reserve growth via SDRs will be, in comparison, an easy affair.

On the other hand, developing countries are asking for a larger share in the future allocation of Special Drawing Rights. Do you consider a "link" between SDRs and development aid as desirable?

According to the existing Agreement on SDRs, developing countries, like all others, receive a share of each allocation according to their member quotas in the International Monetary Fund. This formula was agreed to by the developing countries in 1967. It corresponds, like the similarly determined amount of general drawing rights in the Fund, to the relative needs of the various countries for monetary reserve instruments.

I would not consider it useful to go beyond that. One should not mix up money creation and development aid (which requires a more permanent transfer of real resources).

Pros and Cons of Floating

Let us now come to the problem of "floating". Has it up to now been a suitable method for overcoming the external monetary difficulties?

In retrospect it can be said that the floating of the D-mark was the only practicable way out of the currency crisis of last May. Whether the same can be said of the floating of a number of currencies since the middle of August is still an open question. It is somewhat doubtful whether this general, or nearly general, floating of all major currencies will by itself lead to the desired end result, namely a realistic and sustainable pattern of exchange rates.

Some experts hold the belief that currency crises could have been avoided in the past if we had had a system of flexible rates instead of fixed parities. What is your view on this?

A system where all major currencies floated against each other would have had other concomitant difficulties — distortions of relative exchange rates through restrictive practices and interventions, competitive devaluations, and other "beggar-my-neighbour" policies. In my view, it would be more correct to say that we would probably have had fewer, or at least less severe, currency crises if countries had been willing to adjust unrealistic par values sooner, and if parity decisions had been taken out of the realm of prestige politics.

European Currency Union

Over the last few months the Federal Minister of Economics

and Finance, Professor Schiller, has repeatedly proposed the formation of an EEC currency block with fixed parities inside and flexible rates vis-à-vis the outside world. Do you believe that this could be a contribution towards a permanent solution of the currency problems?

I don't think that Professor Schiller has really meant his proposal to be a permanent solution. It was intended as a transitional system until the dollar problem was solved or, in other words, until realistic and sustainable equilibrium rates between the dollar and the other major currencies had been found. When this is attained a new par value system will be established. It will, however, in all likelihood be a system where there will be larger margins of fluctuations (perhaps up to 3 p.c.) vis-à-vis the dollar, while inside the EEC the margin will be at most as large as before.

Thus even with the return to new parities the EEC currencies would in a certain way form a currency block that fluctuates together against the dollar within the permitted wider margin.

And when should in your view the European Currency Union be set up?

As soon as possible, that is to say, as soon as the conditions are ripe for it.

One cannot put a definite time tag on it. It depends, of course, on what you understand by "European Currency Union". And it depends, above all, on how quickly the economic evolution of the members of the enlarged EEC will converge into a common pattern concerning their trends in prices and costs, balances of payments etc., and finally, how soon they are ready to hand over a large part of their monetary sovereignty to a common body.

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