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Article — Digitized Version

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Intereconomics

Suggested Citation: Scharrer, Hans-Eckart (1972) : High time for monetary reform, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 07, Iss. 7, pp. 194-, <https://doi.org/10.1007/BF02929859>

This Version is available at:

<https://hdl.handle.net/10419/138658>

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High Time for Monetary Reform

The renewed floating of the £ sterling set an abrupt end to the short period of treacherous calm on the foreign-exchange markets. The results of the Washington Realignment became obsolete unexpectedly soon. The situation is dangerous. More and more governments tighten their exchange controls. Thereby they do not only shield themselves from speculative money movements but provide at the same time barriers against the free flow of goods and long-term capital. The short-sighted protective policy endangers directly international economic interdependence and thus the basic elements of the prosperity achieved or hoped for in industrial nations as well as LDCs. This hazardous development can be stopped only by a fundamental reform of the international monetary system.

Half a year after the Smithsonian Agreement was concluded the reform debate is still centred round the preliminary question as to which institution should be responsible for advancing the reform. Agreement seems to be within reach, but it might become autumn before actual expertise discussions can commence. The International Monetary Fund's study, parts of which have become known by way of indiscretion, can be a good basis for these talks. Other than the fragmentary statements of national monetary politicians, the study stands out for its integrating approach. Convertibility, liquidity and exchange-rate flexibility do not appear as isolated

problems but as tasks to be solved simultaneously.

For one thing, the point is to remove the Central Banks' dollar overhang of roughly 50 bn and to prevent the accumulation of new currency holdings. To this end the IMF suggests that the Central Banks transfer their dollar reserves to the Fund in exchange for newly issued Special Drawing Rights (SDRs) and hold their reserves also in future exclusively in SDRs (or gold). This would simultaneously eliminate the danger for our monetary system to develop into a multi-reserve standard which is constantly confronted with the threat of destabilising exchange operations among the individual reserve currencies. However, the Central Banks cannot be forced to adopt such a policy. Therefore it is necessary to make SDRs deposits more attractive by raising their interest rate from 1.5 to 5–6 p.c., a rate at which they can successfully compete with the reserve currencies.

Secondly, the dollar should not be the only intervention currency in future. The IMF suggests that each Central Bank should intervene henceforth in those currencies vis-à-vis which the exchange rate of its own currency has declined. The model follows closely the intervention scheme between the EEC Central Banks. Binding regulations are required to settle the balances thus arising between the Central Banks. It is desirable to effect settlement quickly – within a month's time, or so. This applies also to the dollar whose special role should come to an end.

A short-term clearance of balances can be realised only if all countries, including the USA, are enabled, and forced at the same time, to maintain and restore balance-of-payments equilibrium. The most suitable instrument for this purpose are periodical parity corrections in small steps. The Fund Articles should be supplemented by unequivocal rules stipulating the conditions under which, and the extent to which, parity changes have to be effected. This is the most important, and at the same time most disputed, part of the reform suggestions. As a whip to surplus countries, Connally's "reserve tax" does not appear to be all that inept in this connection. The deficit countries' interest in a devaluation must certainly be enhanced, too, by reducing the enormous financing facilities open to them.

Since the currency crisis of last year there tends to be a change in the industrial countries' attitudes towards the question of fixed parities. Parity changes are more and more recognised as an admissible economic policy tool. However, only devaluations have so far been considered worthy of discussion, whereas revaluations are still taboo. This calls for the provision of binding rules of conduct so that an uncontrolled devaluation race can be prevented. The EEC could make an important contribution towards developing such rules. In doing so it would serve the world and itself better than by perfecting its exchange restrictions.

Hans-Eckart Scharrer