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Disappointing Results

by Dr Hans-Eckart Scharrer

The Kenya safari of the finance ministers, Central Bank governors and their officials from 126 countries has surely been an enjoyable touristic event. With regard to a viable reform of the international monetary system it has not achieved any progress. This was not so much attributable to the attractions of the host country as to the fact that the members of the Committee of Twenty, after all, had not approached each other during their one-year negotiations to the extent some euphoristic remarks made believe in the past few weeks. In fact, there is no need for hurry: Although it is true that the foreign-exchange markets are in a state of "anarchism", i.e. the exchange rates occasionally do not move in line with the wishes of politicians, international trade flourishes splendidly. Therefore, experts should well take their time to think about the gist of the problem of the planned reform in leisure.

Gist of the Problem

The gist of the problem, which outweighs by far the importance of all other problems, is the question how the future balance-of-payments adjustments mechanism is to function. Agreement was reached already some time ago on the compromise formula of "fixed but adjustable parities". Now as before rather differing ideas of the methods of balance-of-payments adjustments, diagnosis of the need for adjustment, and possible sanctions against

countries with a continuous balance-of-payments disequilibrium are hidden behind that accepted phrase. As far as the adjustment method — internal adjustment or change of exchange rates — is concerned, the unbiased observer gains the impression as though the reformers still live in the era of the sixties when fixed exchange rates were the rule and parity changes the exception. In fact, the very point seems to be: how can more — but not too much — flexibility be given to a system of fixed exchange rates? But the question relevant today is whether — and, if appropriate, how — the floating exchange rates can and will be stabilised. Consultations which have taken place hitherto have naturally produced some contributions towards solving this question. After initial, somewhat exaggerated expectations about the possible role of free exchange rates in the realisation of domestic economic aims (full employment or price stability), it now appears that — not least on account of exchanges of experiences within the Committee of Twenty — a more balanced approach is taken in rating the role of internal monetary and fiscal policy, on the one hand, and exchange-rate policy, on the other. The prospects for a more steady development of exchange rates are improved thereby. And yet, the reformers have been, and still are, looking in the wrong direction, and this will be avenged at the latest when the

transition from the present unregulated co-existence of currencies to the new monetary order will have to be effected.

Unrealistic Approach

This unrealistic approach is also noticeable in the considerations of how the necessity of adjustment measures is to be determined. According to American opinion, disproportionate changes of a country's currency reserves shall substantiate the assumption that adjustment measures are required. This assumption could possibly be invalidated, but the burden of proof would rest with the country not willing to take action. The European attitude, on the other hand, is such that changes of reserves (or other indicators), to begin with, only initiate a process of consultations, in the course of which it would first of all have to be examined whether or not economic measures are required at all.

The burden of proof would thus be reverse. In this context the doubt suggests itself whether the EC countries actually have realised the focal point of the reform: the point is nothing less than to break conclusively with the usage of palliating and defending unrealistic exchange rates practised for many years, and to let economic realities instead of wish-dreams be the guideline in future. The proposal of the EC countries and, unfor-

tunately, also the German compromise formula arouse suspicion that it is intended to transfer the Brussels style of consultations also to the IMF: consultations as an alibi to do as one likes. It appears, however, that another question is even more important, namely how the market — or, so to say, the "speculators" — can be convinced that confidence in the parity of a currency is justified in spite of distinct movements of the measuring instrument. The reserve indicator is least suited for supporting confidence, for it is the very signal indicating that the currency can be held within the fluctuation band with great difficulty only. An indicator, which — in the case of wide margins — is governed by the market-rate trend itself, would be somewhat better.

No Effective Sanctions

The third group of open problems concerns the ways and means how infringements of the policy of adaptation can be revenged. This actually is an academic subject. Already the Bretton-Woods-Agreement contains a number of sanctions against deficit as well as surplus countries although, for political reasons, they have never been imposed. The same considerations will prevent effective sanctions also in future — and the new political committee to be

founded will probably not change the situation either. Negative interest payable on surplus reserves, as far as they will ever be charged, will only increase the incentive to invest currency in Euro-markets. Under these circumstances it would appear likely that also after a "reform" decisions on monetary policies, above all on revaluations, will, as a rule, not voluntarily be taken by the monetary authorities but be enforced by "speculation". International capital movements could thus also in future be the necessary catalyst for action in the sphere of currency policy.

If the results of the Committee of Twenty negotiations on adjustment policies have so far been disappointing, this is, for one thing, attributable to the distorted viewpoint of the reformers. Moreover, it is quite obvious that the big countries are not (yet) ready to renounce essential parts of their national competences. Neither the submission to a "blind" adjustment mechanism nor to an organ of the International Monetary Fund appears acceptable at present. The claim for sovereignty and the lacking agreement on fundamentals explain the predilection for vague formulations ("fixed but adjustable parities"), which may be interpreted according to the relevant preferences. This makes it

more difficult, but not impossible to elaborate a sound concept of reform. At the beginning of the Bretton-Woods-system there were also differing ideas of objectives and an agreement with plenty of indeterminate legal terms (typical example: "fundamental disequilibrium"). Yet, the system worked satisfactorily for many years, since a generally accepted complex of written and unwritten rules and standard attitudes had developed in the course of time.

Key Position of the EC

Therefore, the reform will by no means be completed next summer when the Committee of Twenty submits its final report. It will then be a matter of filling the conceptions, which, it is hoped, will be defined more clearly by then. Here the EC will have a key position, for essential elements of the reformed system have already been internally anticipated: the fixed but adjustable parities, the mechanism of consultations, a multilateral system of intervention, the settlement of balances. If the European system can successfully be put into working order, good prospects may also be predicted for the global monetary order; should it fail, or get stuck in formalities, then the chances of the Nairobi system are also small.

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