PANEL

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There is an advantage in being the last speaker on a panel; in contrast to the first speaker, the last speaker has the option whether or not to ignore what other speakers have said. I had written some notes for myself, and I fully expected that every one of my points would have been covered by at least one or more of the other speakers. Many of them have, but I am pleased to discover that there are still one or two things I can say that have not yet been said this morning. I shall try to run very lightly over those items on which I would simply be repeating what has been said before, at the same time not impinging on what comes later in the program.

Need for Non-Disruptive Adjustment

In a program with the title of this one, it is useful to start with the question, why do we care about the adjustment process in the first place? Why is it important? I think that the point Milton Friedman made is the right one – that adjustment will occur in any event, primarily because deficit countries can't go on forever in deficit, and they will have to take some action to eliminate the deficit. It is desirable that the actions they take and how they take them not be disruptive to themselves or to their trading partners. Furthermore, it is important that the process of adjustment be consistent with optimum resource allocation, rather than harmful to resource allocation. It is desirable in particular that adjustment be carried out with a minimum of controls – at least those controls that are harmful to resource allocation. All of that is to state what is fairly obvious.

Importance of When and How

This concern about the adjustment process which, as several speakers have said, has come very much to the fore, has, of course, led to discussion about exchange rates. Let me more or less agree with Milton that the issue is not one of fixed versus flexible exchange

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rates. In my own view, Milton may have exaggerated a little bit the extent to which exchange rate adjustment has been used in the post-war period. I think he has managed to cover almost every industrial country except the U.S. and Japan by including the 1949 set of devaluations which were a sort of "one-shot" adjustment to what had happened during the war. Be that as it may, the idea that exchange rates should remain really fixed among developed countries was somewhat prevalent in the 1950's and early in the 1960's. That view has, I think, been dissipated in recent years and perhaps the best evidence I can use, and the quickest way to say it, is to note a very recent paper by Bob Roosa who, I think it is not unfair to say, had leanings toward the view that rates should remain fixed. In a recent paper, he very eloquently explains why that view was appropriate earlier in the sixties and is not appropriate today. So it is not a question of fixed rates versus flexible rates. The real issue is not *should* exchange rates be changed but *when* and *how* should they be adjusted when they need to be adjusted.

The reasons have been stated very often why the so-called adjustable peg system has not been working well. I won't go over those reasons, but the words "politics," "prestige" and so on get mentioned in that sort of explanation.

Another point about the present adjustable peg system, and an important point, is that when countries do adjust their rates in the discrete, occasional way that is regarded as the hallmark of the present adjustable peg system, there is a tendency for those who devalue to devalue excessively and when an occasional revaluation does occur, it tends to be deficient. That, I would say, is a shortcoming of the system as it has worked up to now.

Now what to do about all this? I am not going to try to impinge on what comes later in the program. One can certainly imagine that without any changes in the Articles of Agreement there could somehow be brought about a change in atmosphere – a change in the behavior of governments – so that the existing par value system would be used for smoother, less disruptive exchange rate adjustment than in the past. This is quite conceivable. To state the case more extremely, one can imagine that countries would somehow be induced to begin to regard small changes in exchange rates, even discrete discretionary ones, as a sort of technical adjustment of an economic policy instrument rather than a major political decision. I might shock both the central bankers and the noncentral bankers here if I made an analogy between small changes in the discount rate

— or bank rate — on the one hand and small changes in the exchange rate on the other. Changes in the discount rate are more or less outside the political sphere. They are regarded as technical adjustments. It is conceivable that a change in attitude toward exchange rates could be brought about whereby one would begin to think of small changes in exchange rates in somewhat the same way one thinks of small changes in central bank discount rates.

Beyond this, there is a spectrum of proposals for greater exchange rate flexibility running all the way from full flexibility to full discretion. And these proposals tend to shade into each other. One of the well-known proposals is the so-called gliding parity in which the parity is established each quarter or so on the basis of an average of market rates in the past. Even such an automatic system would presumably require some sort of agreement or rules of the game on intervention in the exchange market by monetary authorities. It is unlikely, as Milton Friedman and others have said, that central banks would completely eschew their prerogative to intervene. There would be some discretion even in such a system. That system shades into a system of discretionary crawling pegs in which there would be presumptive rules to guide discretionary changes, along the lines of suggestions by Bob Triffin and others. My main purpose here is not to go into the details of these various proposals but to indicate that they aren't all terribly far away from each other.

Need for Bias Toward Revaluation

My next to last point is that, as we think about various devices for improving the adjustment mechanism, there is much to be said for trying to inject into the exchange rate system a bias toward revaluation. I have already noted that the system now contains a bias toward devaluation. This is so in two senses: first, devaluations occur much more frequently than revaluations; second, devaluations tend to be much larger than revaluations because, as I said earlier, those who devalue prefer to overshoot the mark, while those who revalue have every reason from their point of view to undershoot the mark. I think there now exists a convergence of interests in the direction of biasing the system toward revaluation. We have heard proposals from some European officials in favor of an upward crawling peg, which is one way of injecting a bias toward revaluation. They feel that anti-inflationary discipline would be stronger if it were somehow more difficult for countries to devalue than to revalue — more difficult in the sense of the procedures required in the Fund. Their feeling is that if it were more difficult to devalue than to revalue, then perhaps domestic anti-inflationary policies would be stronger than otherwise. Countries would not feel that they could just devalue and therefore offset the effects of inflationary domestic policies. There is another reason why some European officials have a preference toward a system with a bias toward revaluation; they feel that it is a way for countries who don't inflate to protect themselves from the inflation of their trade partners. Those two related reasons converge with the interest of the United States in the system. Given what Professor Haberler has said – that the United States cannot change its exchange rate by its own initiative – it is in the interest of the United States that there not be excessive devaluations against the dollar over time. Since the bias now exists toward devaluation as against revaluation, there is something to be said if we try to change the system by offsetting that with a bias in the other direction.

My final and very brief point is really a reaction to Milton Friedman. I can't resist disagreeing with him on the relevance of SDR's to the adjustment process. I was presumptuous enough to send to the members of this group a paper which I happened to give last week – in Chicago, of all places – which tries to make the case – *I* think with great success – that a steady increase in reserves is a necessary though not a sufficient condition for an effective working of the balance-of-payments adjustment process.