The European Monetary System: Tombstone or Cornerstone?

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The interested layman will get the gist of this overlong and overtechnical paper by looking merely at its Synopsis, Summary and Conclusions, and whatever other passages are of interest to him, skipping the documentary verbiage designed for skeptical experts.

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Synopsis

The breakdown of the Bretton Woods international monetary system has been followed by floating exchange rates. This led initially to a huge depreciation of a previously overvalued dollar vis-à-vis its major rival currencies on the exchange market: the D-mark, the Swiss franc, and the yen. The partial, but spectacular, recovery of the dollar since 1979 is *not* due to any improvement of the U.S. balance of payments on current account, but to enormous inflows of speculative capital, due mostly to fears of a third world war and to exceedingly high U.S. interest rates, related themselves to the unprecedented fiscal deficits triggered by sharp increases of military expenditures. These capital movements are unacceptable and unsustainable in the long- or even medium-run for the rest of the world, and the renewed overvaluation—undercompetitiveness—of the dollar is increasingly unbearable for U.S. firms exposed to foreign competition at home and abroad. Trade deficits of about $110 billion this year, according to official estimates, are as absurd for the most industrialized country of the world as their financing by capital imports from poorer and less capitalized countries.

The restoration of a viable world monetary order continues to demand the fundamental reforms agreed upon after 10 years of continuous debates and negotiations in the International Monetary Fund (IMF), the Group of Ten, the Committee of Twenty, etc., but bizarrely put on ice by the Second Amendment to the IMF Articles of Agreement. No agreement is yet in sight, however, on the major reform proposed by the negotiators, i.e., the replacement of *national* reserve currencies—primarily the dollar—by a reformed SDR *(Special Drawing Rights)* as the main instrument for *international* settlements and reserve accumulation by central banks, commercial banks, etc.

Pending such a distant agreement, the countries other than the United States are desperately trying to minimize the impact of the present world monetary disorder upon their national economies. They seek to stabilize their exchange rates vis-à-vis their main trading partners through regional agreements, making them less dependent on the fluctuations of the dollar. The *European Monetary System* (EMS) has been partially successful in this respect. It is still very far from its ultimate objective of full Monetary and Economic Union but has nevertheless succeeded in preserving, or restoring fairly rapidly, stable competitive *real* exchange rates between its member currencies through appropriate realignments of *nominal* exchange rates, offsetting persistent differences in national rates of inflation.

The keystone of this system, the ECU has begun to compete spectacularly with the Eurodollar and other Eurocurrencies for the denomination of international contracts, particularly in the Eurobond market and in the lending and borrowing transactions of commercial banks. This role is likely to increase further if and when the dollar begins to depreciate, as is regarded highly probable and desirable, both in the United States and abroad, to correct its present overvaluation.

The parallel appreciation of the stronger EMS currencies will, however, increase exchange rate tensions between them and the weaker EMS currencies, and require the strengthening of the system initially envisaged after two years of operation, but not yet implemented in practice. If this is finally achieved, the EMS success should inspire a renewed drive for a reformed world monetary order in which regional cooperation could proceed much further than is feasible worldwide between more developed and less developed countries, and between Communist and non-Communist countries . The IMF could then devote its limited time and capabilities to tackling the balance of payments problems between such regions rather than between their member countries.

The World Monetary System (or Scandal?): 1969–1983

The following three tables, derived from the *International Financial Statistics* of the International Monetary Fund, summarize the crucial defects of the present world monetary system:

1. Its *inflationary proclivities:*

Table A
1983 Indices of World Inflation (1969 = 100)

Year Averages		Percent	
Consumer Prices	:	435	
Money	:	539	
End of Year Estimates			
International Reserves other than gold	:	883	
of which: Foreign Exchange	:	900	
International Reserves, including gold	:	947	
Euro-Currency Liabilities	:	2,000	
Gold Price ($381.50 per ounce)	:	1,090	(with a peak of more than 2,400 percent, at $850 per ounce on January 21, 1980)

2. The *distorted investment pattern* of its major assets component (foreign exchange), whose main creditors are the poorest and least capitalized countries of the Third World, and the major debtor the United States.

Table B
Foreign Exchange Assets and Liabilities
($ billions)

	End of 1969	1970–83 Changes	End of 1983	End of 1983 in %
I Assets of:	33	+263	297	100
United States	3	+3	6	2
Other Industrial Countries:	17	+117	134	45
Nonindustrial Countries.	13	+143	156	53
Oil Exporting	3	+62	65	22
Other	11	+81	92	31
II Liabilities (−) of	−33	−263	−297	−100
United States	−18	−179	−197	−66
Other Industrial Countries:	−16	−84	−100	−34
III Net Assets, or Liabilities (−)	x	x	x	x
Debtors: United States	−15	−176	−191	−100
Creditors:	+15	+176	+191	+100
Other Industrial Countries:	+2	+33	+35	+18
Nonindustrial Countries:	+13	+143	+156	+82
Oil Exporting	+3	+62	+64	+34
Other	+11	+81	+92	+48

3. The fantastic increase of the abnormal *current account deficits* of the United States, financed by equally *abnormal capital inflows;* and the abrupt curtailment of U.S. banks' capital exports in 1983.

Table C
U.S. Balance of Payments and Capital Flows: Yearly Averages
($ billions)

	with capital flows adjusted for valuation and coverage				with capital flows unadjusted		
	1950–69	1970–78	1979–82	1982	1982	1983	Official Forecasts 1984
I Earnings on Past Investments	+4	+13	+30	+27	+27	+24	
II Other Current Transactions:	−2	−13	−32	−39	−39	−64	
Merchandise	+4	−8	−29	−36	−36	−61	−110
Other	−2	−5	−3	−3	−3	−4	
Current-Account (I+II)	+2	−	−2	−11	−11	−41	−80
I Valuation and Coverage Adjustments	−1	+1	−6	−18	n.a.	n.a.	
II Net Capital Flows[1]	+1	+1	−8	−29	−11	−41	−80
A. Foreign Aid	+1	+3	+5	+6	+6	+5	
B. Other:	−	−2	−13	−34	−17	−46	
1. Official Reserves	−1	−17	−1	−4	+2	−5	
2. U.S. Banks and Treasury Securities	−1	+7	+26	+38	+38	−35	
3. Other:	+2	+8	−38	−68	−57	−6	
(excldg. Discrepancy)	(+2)	(+10)	(−7)	(−27)	(−15)	(+1)	
(Stat. Discrepancy)	−	(−1)	(−30)	(−41)	(−41)	(−7)	
ASSETS	+5	+33	+97	+117	+118	+49	
A. Foreign Aid	+1	+3	+5	+6	+6	+5	
B. Other:	+4	+30	+92	+112	+112	+44	
1. Official Reserves	−	−	+4	+4	+5	+2	
2. Bank Claims	+1	+13	+68	+109	+109	+25	
3. Other	+4	+16	+20	−1	−2	+18	
LIABILITIES (−)	−4	−32	−105	−146	−129	−90	
1. To Official Inst.	−1	−17	−5	−8	−3	−6	
2. U.S. Banks & Treasury Securities	−1	−6	−42	−71	−71	−60	
3. Other:	−2	−8	−57	−67	−55	−24	
(excldg. Discrepancy)	(−1)	(−7)	(−27)	(−25)	(−13)	(−17)	
(Stat. Discrepancy)	(−1)	(−1)	(−30)	(−41)	(−41)	(−7)	

[1]Capital exports shown as +, and imports as −

I. Shortcomings and Unviability of the Dollar-Anchored World Monetary System

1. *Introductory Remarks*

The economic disaster of the last decade is summarized by economists in the word *"stagflation"* which suggests that it began with "stagnation" *followed* by inflation. The word *"infession"* would be less misleading, since inflation *came first* and was followed not by mere stagnation, but by *recession.*

The roots of this inflation lie outside the monetary field: in the unprecedented growth of material production which threatens to deplete world resources in some economic sectors—particularly energy, and more specially oil reserves—and can be met only at increasing production and investment costs. Future historians will probably describe this phenomenon as a short parenthesis in world history:

a) initiated only two centuries ago by the *industrial revolution* which helped meet the most basic needs of man for food, shelter, health, etc;
b) sustained later by the *advertising revolution* which created needs, previously unperceived, for a more comfortable life;
c) accelerated in the 1950s and 1960s by the success of the *Keynesian revolution* in minimizing the cyclical *recessions* which previously slowed down periodically the pace of growth; and,
d) last but not least, compounded by the *armament explosion* which threatens us today with a nuclear suicide.

These sectorial inflationary pressures were met by national monetary policies in either of the two following manners, or a combination of both:

a) In most countries, by far, they transmitted these inflationary pressures to the economy in general, by *permissive,* or *accommodating* policies, increasing money supply sufficiently to finance the contagion of price and wage increases from the affected sectors to the others.
b) In a small core of countries—particularly the United States and Western Europe—they tried to preserve the overall stability of prices and wages by increasing the money supply only moderately, and often setting thereby price and wage increases in the affected sectors by price and wage contraction—at the risk of unemployment—in the other sectors of the economy.

The inevitable result of these divergent policies was steep declines in the exchange rates of the countries with accommodating policies vis-à-vis the currencies of the countries following anti-inflationary policies. Measured in the latter countries' currencies, however, world prices rose only moderately in the 1960s: by 4 percent yearly on the average for consumers' prices, and only about 1 percent or less for export and import unit prices. But their growth rose to about 6 percent a year on all three of these measurements in the following three years (1970–72), i.e., well before the first explosion of oil prices at the end of 1973; and to between 10 and 12.5 percent a year in the

next 11 years (1973–83) of floating exchange rates.[1]

As distinct from *national* inflations and recessions, *worldwide* inflations and recessions are primarily linked, in my opinion, to the breakdown of the world monetary system. The deep and prolonged world recession of the 1930s followed the collapse, in September 1931, of the world key-currency of the times: the pound sterling. The recession of the 1970s followed similarly the suspension, 40 years later nearly to the day, in August 1971, of the convertibility of the successor key-currency: the U.S. dollar. But it is accompanied this time by a world inflation, largely due to the explosion of foreign exchange reserves by 744 percent between 1969 and 1982—in sharp contrast with their 25 percent decline from 1928 to 1937—and to the concomitant explosion of the international private capital market, practically paralyzed after 1929.

2. *Inflationary Explosion of World Reserves*

Table 1 summarizes the evolution of gross and net international monetary reserves from the end of 1969 to the end of 1983, measured at constant gold prices (35 per ounce) and dollars equal to SDRs in the first two columns, and at $ market gold prices and $-SDR exchange rates in the third column.

[1]Calculated from the estimates of *International Financial Statistics (Yearbook* 1983 and March 1984).

Table 1
Sources of International Monetary Reserves: 1969–1983
(SDR or $ billions)

	End of 1969	End of 1983		Changes over Years 1970–1983			
				Total	Transactions	Impact of Gold Price and Exchange Rate Fluctuations	
	(a)[1]	(b)[1]	(c)[2]	(d=c−a=e+f)	(e=b−a)	Total (f=g+h)	SDR Gold Price (g)	$–SDR Exchange Rate
GROSS RESERVES	79	373	748	669	294	375	342	34
I World Gold	41	40	435	394	−1	395	376	20
II Credit Reserves	38	333	313	275	295	−20	−34	14
A. Foreign Exchange	33	283	297	263	250	13	x	13
B. Concerted Reserve Creation	4	50	17	12	45	−33	−34	1
1. SDR Allocations	x	21	22	22	21	1	x	1
2. Net IMF Credit	4	28	−6	−10	24	−34	−34	–
a) *Reserve Positions in* IMF	7	39	41	34	32	2	x	2
b) *minus* acquired through gold and SDR transfers to IMF	−2	−11	−47	−44	−8	−36	−34	−2
NET RESERVES[3]	40	39	398	358	−2	359	342	18
I World Gold	41	40	435	394	−1	395	376	20
II *minus* Unallotted IMF Profits[4]	−1	−1	−37	−37	−1	−36	−34	−2
A. on Credit Transactions	−1	−1	−1	−1	−1	–	x	–
B. on Gold Holdings	x	x	−36	−36	x	−36	−34	−2
A. Gross IMF Lending (−)[5]	−5	−30	−31	−26	−25	−1	x	−1
B. Net IMF Credit	4	28	−6	−10	24	−34	−34	–

[1]*Measured in SDRs = dollars, at constant gold price of $35 per ounce.*
[2]Measured in dollars, at market gold prices and $–SDR exchange rates.
[3]*Net* foreign exchange and SDR assets and liabilities equal 0 by definition.
[4]*Including, after 1980, minor accounting adjustments for member's short-term borrowings under enlarged access policy, and for borrowed reserves held in* suspense.
[5]Including in 1969, gold deposits and investments of the IMF in the United States ($1,019 million) and in the United Kingdom ($40 million).
Source: Calculated from *International Financial Statistics, Yearbook 1983*, pp. 25–53, and March 1984, pp. 28–43.

a) The evolution of *gross reserves*, shown in the top half of the table, suggests the following observations:
   i) First and foremost, the *inflationary explosion of credit reserves* (i.e., of reserves other than gold), by $275 billion from $38 billion to $313 billion (line II). Credit transactions increased world reserves more than seven times as much in this short span of 14 years as in all previous years and centuries since Adam and Eve. This represents an average increase of 16.3 percent per year, far in excess of the *IFS* estimate (in its 1983 *Yearbook*, p. 87) of the 3.5 percent average increase of world Gross Domestic Product at constant prices over the years 1970–1981,[2] but approximately equal to the obviously inflationary 15.2 percent yearly increase of money and quasimoney over this period (1983 *IFS* Yearbook, p. 65).[3]

      This credit reserve explosion is due nearly entirely (96 percent) to the accumulation of *"foreign exchange"* reserves (see line IIA) in a few *national* currencies—primarily U.S. dollars—as *international* reserves. Its other component part, *concerted credit creation* (line IIB) increased only slightly, cumulative allocations of *Special Drawing Rights* (line IIB1) being relatively small and nearly half of them offset by the decline of *Net IMF Credits* (line IIB2), i.e., the increase of *Reserve Positions in the Fund* (line IIB2, a) other than those acquired by the transfer to the IMF of previously accumulated gold and SDR holdings (line IIB2, b).
   ii) Foreign exchange holdings also account for nearly 85 percent ($250 billion) of the increase of gross reserves including gold, measured at constant gold prices and $-SDR exchange rates ($290 billion), and concerted reserve creation for only 15 percent ($45 billion).
   iii) The near decoupling of gross reserves (including gold), measured in dollars at fluctuating market prices and exchange rates, reflects obviously a total failure of official policies, which had repeatedly proclaimed, until defeated by events, the intangibility of the $35 per ounce price of the U.S. dollar on which the world system had been anchored at Bretton Woods.

b) The bottom half of Table 1 shows the evolution of world *net* reserves, i.e., of the gross assets recorded at the top of the table *minus* reserve liabilities: foreign exchange liabilities, "contingent" liabilities for SDR allocations, and reserve liabilities to the IMF. For the world as a whole, *net* liabilities for foreign exchange and SDR allocations are zero by definition, as pointed out in footnote (3). Net world reserves are equal to official world gold holdings (line I), *minus* the profits of

[2]1982 estimates are not yet published.

[3]Gold is excluded from these calculations because the enormous increase at $ market prices is due exclusively to price increases and reflected nearly exclusively in "bookkeeping profits" sterilized until now by central banks, rather than in increases in the monetary issues of reserve money.

the IMF on its credit transactions and on its own gold holdings (first lines A and B under II), equal themselves to the difference between net IMF credits (last IIB line = line IIB2 of the top half of the Table) and gross borrowings from the Fund (penultimate line IIA).

The $358 billion increase in net reserves, shown in the 4th column of the first line is due more than entirely to the impact of the market fluctuations of SDR gold prices ($342 billion) and $-SDR exchange rates ($18 billion), whose stability had been previously proclaimed by the authorities as the two "unshakable pillars" of any reformed Bretton Woods system. Measured at stable gold prices and $-SDR exchange rates, net reserves show indeed a slight decline over this period, in sharp contrast with their huge increase when measured at market gold prices and exchange rates.

3. *Distorted Pattern of the Regional Distribution of International Reserves*

A second characteristic of the present system (or nonsystem?) of world reserve creation is also the exact opposite of the proclaimed goal of our official authorities and of plain common sense. Economic logic as well as human concerns would require capital flows to move from the richer and more capitalized countries toward the poorer and less capitalized countries, in order to accelerate their development and to enable them to finance levels of consumption indispensable to the very survival of their people. This objective is indeed untiringly reaffirmed in pious United Nations resolutions, but in the sector most susceptible of being oriented by responsible officials, i.e., the creation and investment of international monetary reserves, the present system leads to the opposite result: the financing of the richer and more heavily capitalized countries by poorer, capital-short countries.

This comes out clearly from the estimates summarized in Table 2.[4]

[4]The net reserve estimates on line III differ from those shown in Table 1 by the amount of IMF gold holdings, unassignable regionally.

Table 2
Sources and Regional Distribution of Net International Monetary Reserves:1969–1983
(SDR or $ billions)

	End of 1969	End of 1983		Changes over Years 1970–1983				
				Total	Transactions	Impact of Gold Price and Exchange Rate Fluctuations		
	(a)[1]	(b)[1]	(c)[2]	(d=c−a=e+f)	(e=b−a)	Total (f=g+h)	Gold Price (g)	$–SDR Exchange Rate (h)
I. Countries Gold	39	36	396	357	−2	359	342	19
United States	12	9	100	89	−3	91	87	5
Other Industrial Countries	21	22	235	214	1	213	202	11
Nonindustrial Countries:	6	6	60	55	–	55	52	3
Oil Exporting	1	1	16	15	–	15	14	1
Other	4	4	44	40	–	41	39	2
II. Credit Reserves	2	2	2	1	1	–	x	–
United States	−14	−171	−180	−166	−158	−8	x	−8
Other Industrial Countries	2	45	47	45	43	2	x	2
Nonindustrial Countries:	13	129	135	122	116	6	x	6
Oil Exporting	3	73	76	73	70	4	x	4
Other	10	56	59	49	46	3	x	3
A. Foreign Exchange	x	x	x	x	x	x	x	x
United States	−15	−182	−191	−176	−167	−9	x	−9
Other Industrial Countries:	2	33	35	33	31	2	x	2
Nonindustrial Countries:	13	149	156	143	136	7	x	7
Oil Exporting	3	62	65	62	59	3	x	3
Other	11	87	92	81	77	4	x	4
B. Concerted Reserves	2	2	2	1	1	–	x	–
United States	1	11	11	10	9	1	x	1
Other Industrial Countries	1	12	13	12	11	1	x	1
Nonindustrial Countries:	–	−20	−21	−21	−20	−1	x	−1
Oil Exporting	–	11	11	11	11	–	x	1
Other	−1	−31	−33	−32	−31	−2	x	−2

[1]Measured in SDRs = dollars at constant gold price of $35 per ounce.
[2]Measured in dollars at market gold prices and $–SDR exchange rates.
Source: Calculated from *International Financial Statistics, Yearbook 1983*, pp. 25–53; and March 1984, pp. 28–43; and *Federal Reserve Bulletin* for U.S. foreign-exchange liabilities.

Table 2 (continued)
Sources and Regional Distribution of Net International Monetary Reserves:1969–1983
(SDR or $ billions)

	End of 1969	End of 1983		Changes over Years 1970–1983				
				Total	Transactions	Impact of Gold Price and Exchange Rate Fluctuations		
	(a)[1]	(b)[1]	(c)[2]	(d = c − a = e + f)	(e = b − a)	Total (f = g + h)	Gold Price (g)	$–SDR Exchange Rate (h)
III Total Net Reserves	40	39	398	358	−2	360	342	19
United States	−2	−162	−79	−77	−160	83	87	−4
Other Industrial Countries	23	66	282	259	43	216	202	13
Nonindustrial Countries:	19	134	195	177	116	61	52	9
Oil Exporting	4	74	92	87	71	18	14	4
Other	15	60	103	88	46	43	39	5

[1]Measured in SDRs = dollars at constant gold price of $35 per ounce.
[2]Measured in dollars at market gold prices and $–SDR exchange rates.
Source: Calculated from *International Financial Statistics, Yearbook 1983,* pp. 25–53; and March 1984, pp. 28–43; and *Federal Reserve Bulletin* for U.S. foreign-exchange liabilities.

a) *Measured at constant gold prices and $-SDR exchange rates,* the United States emerges, at the end of 1983, as a net reserve *debtor* of $162 billion and other countries as net reserve *creditors* of $200 billion, the $38 billion difference between world claims and debts being accounted for by countries' gold reserves ($36 billion) and an insignificant amount of net reserve claims on the IMF. (See lines III, I and IIB of the third column, and for transaction changes from the end of 1969 to the end of 1983, the same lines of the fifth column.) This is, once again, due entirely to the constellation of foreign exchange accounts, in which the rest of the world had accumulated net claims of $182 billion on the United States, as against $15 billion in 1969. (See line IIA of the same columns.)

It should also be noted that the relatively richer industrial countries were the smallest net creditors, the largest being the nonindustrial, non-oil exporting countries of the Third World.

As for the countries' gold reserves of $36 billion, practically unchanged in volume over this period, nearly 85 percent of them were held by the industrial countries (25 percent by the United States and 59 percent by the other industrial countries) and only 15 percent by the nonindustrial countries.

b) *Fluctuations of exchange rates, and particularly of gold prices* mostly benefited the United States and the other industrial countries: they reduced by $83 billion—from $162 billion to $79 billion—the net reserve debt of the United States, and increased by $216 billion—from $66 billion to $282 billion—the net reserve claims of the other industrial countries. All in all, 83 percent of the $360 billion of net reserve increases—due entirely to these fluctuations—accrued to the industrial countries, and only 17 percent to the nonindustrial countries.

c) As mentioned, *concerted credit creation* had only an insignificant impact on net reserves. Appendix Tables A1 and A2 provide more information in this respect. Note that the industrial countries received two-thirds ($15 billion) of total SDR allocations ($22.4 billion), and the nonindustrial countries only one-third ($7.3 billion), but that the IMF increased its lending to the nonindustrial countries from only $1 billion in 1969 to $31 billion in 1983, while its loans of $4 billion to the industrial countries were repaid practically in their entirety.

4. *Impact upon U.S. Reserves*

The impact of this method (?) of reserve creation upon the net reserves of the United States *made*, of course, *impossible* as I had predicted to the U.S. Congress in 1959, *the preservation of the gold convertibility of the dollar* at $35 per ounce and of its parity with the SDR. Net U.S. reserves fell dramatically from *plus* $23 billion at the end of 1949 to *minus* $24 billion at the end of June 1971, and the convertibility of the dollar, at a fixed price or exchange rate, into gold or any foreign currency was "temporarily" suspended on August 15, 1971.

The evolution of world reserves, measured at $ market prices and exchange rates, has been practically determined ever since, as already noted above, by the wild fluctuations of the $-SDR exchange rate, but particularly of the price of gold. A peak of $850 per ounce (more than *24 times* its theoretical par of $35 per ounce) was briefly reached on January 21, 1980 and followed by a *decline of nearly two-thirds* to less than $300 per ounce in mid 1982, with considerable up and down movements, bringing it, for example, to $456.90 at the end of 1982 and $381.50 at the end of 1983.

Bizarrely at first view—and certainly unforeseen by me in my 1959 forecast to the U.S. Congress—this did not slow down the accumulation of dollars by foreign central banks. Their foreign exchange claims on the United States rose indeed by 10 times as much—from $18 billion in 1969 to $191 billion in 1983—in 14 years as in all preceding years. Being able to settle their deficits in dollars, the U.S. monetary authorities retained only an insignificant portion of these inflows in foreign exchange reserves. (See the U.S. lines in the "Foreign Exchange" columns of Appendix Table A2.)

They were, instead, "recycled" abroad by commercial banks. To understand this process, turn to Table 3, which summarizes the evolution of the U.S. international investment position over the years 1949–82.[5] As indicated in the footnotes to Appendix Table A4, these estimates must be taken with several bags, rather than grains, of salt. Their broad order of magnitude remains, however, highly significant.

[5]These estimates differ slightly from those of Table 2 above and of Appendix Tables A3 and A4, because they do not include the foreign exchange liabilities of foreign branches of U.S. banks to official institutions.

Table 3
The International Investment Position of the United States: 1949–1982
($ billions)

	End of Year				Average Yearly Flows				Year
	1949	1969	1978	1982	1950-69	1970-82	1970-78	1979-82	1982
I. LIABILITIES (−)	−20	−103	−387	−804	−4	−54	−32	−104	−146
A. Money Market to:	−7	−49	−263	−450	−2	−31	−24	−47	−80
1. Official Institutions	−3	−19	−176	−195	−1	−14	−17	−5	−8
2. Other	−4	−30	−87	−255	−1	−17	−6	−42	−72
B. Other	−13	−54	−124	−354	−2	−23	−8	−57	−67
1. excluding Statistical Discrepancy	−8	−51	−112	−221	−2	−13	−7	−27	−25
a) Direct Investments	−3	−12	−42	−102	−	−7	−3	−15	−11
b) Portfolio Investments	−3	−32	−54	−93	−2	−5	−2	−10	−18
c) of U.S. Nonbanking Concerns	−3	−7	−16	−26	−	−2	−1	−2	+4
2. Statistical Discrepancy	−5	−3	−12	−133	−	−10	−1	−30	−41
II. ASSETS	54	159	448	834	+5	+52	+33	+97	+117
A. Excluding Foreign Aid	43	128	394	760	+4	+49	+30	+92	+112
1. Money Market:	27	30	150	436	−	+31	+13	+72	+113
a) Official Reserves	26	17	19	34	−	+1	−	+4	+4
b) Bank Claims	1	13	131	402	+1	+30	+13	+68	+109
2. Other	16	98	244	324	+4	+17	+16	+20	−1
1) Direct Investments	11	71	163	221	+3	+12	+10	+15	−5
2) Portfolio Investments	4	19	53	75	+1	+4	+4	+5	+12
3) of U.S. Nonbanking Concerns	1	8	28	27	−	+2	+2	−	−9
B. Foreign Aid	11	31	54	74	+1	+3	+3	+5	+6
III. NET ASSETS	+34	+56	+61	+30	+1	−2	+1	−8	−29
A. Excluding Foreign Aid	+23	+25	+7	−44	−	−5	−2	−13	−34
1. Money Market	+21	−19	−113	−14	−2	−	−10	+25	+34
a) Official Reserves	+23	−2	−157	−161	−1	−12	−17	−1	−4
b) Other	−2	−17	+44	+147	−1	+13	+7	+26	+38
2. Other	+2	+44	+120	−30	+2	−6	+8	−38	−68
a) excluding Statistical Discrepancy	+7	+47	+132	+103	+2	+4	+10	−7	−27

Table 3 (continued)
The International Investment Position of the United States: 1949–1982
($ billions)

	End of Year				Average Yearly Flows				Year
	1949	1969	1978	1982	1950-69	1970-82	1970-78	1979-82	1982
1) Direct Investments	+8	+59	+120	+119	+3	+5	+7	–	−16
2) *Portfolio Investments*	+1	−13	–	18	−1	–	+2	−4	−6
3) of U.S. Nonbanking Concerns	−2	+1	+12	+2	–	–	+1	−3	−5
b) Statistical Discrepancy	−5	−3	−12	−133	–	−10	−1	−30	−41
B. Foreign Aid	+11	+31	+54	+74	+1	+3	+3	+5	+6

Sources: See Appendix Table A4

Net Assets (line III) are relatively minor thoughout, and far less significant than *gross* assets and liabilities, except that their minor size shows that the United States is not using foreign capital inflows to finance domestic consumption and investments. It "recycles" them nearly entirely abroad, thus financing the mounting balance of payments deficits of industrial as well as of Third World countries. The acceptance of the dollar by foreign countries as the major so-called "parallel currency" of the world enables it to play the role of "world banker," just as the previous acceptance of sterling in the same role enabled the United Kingdom to be the main "world banker" of the XIXth century and of the early interwar period, until the collapse of the pound in 1931.

The table begins with liabilities (line I) rather than assets, because their enormous and persistent increase is primarily due to this world currency role of the dollar, and is the major explanation of the ability of the United States to increase its assets abroad approximately on the same scale, by about $52 billion a year in the 1970–82 period, with a peak of $117 billion in 1982 (line II).

Lines IIA and IIIA exclude foreign aid assets, held mostly on the countries of the Third World, more akin in fact to "grants" than to real assets, and unusable to support the dollar rate on the exchange markets of the world vis-à-vis its main rival currencies, such as the mark, the Swiss franc and the yen.

The breakdown of assets and liabilities between "money market" (line 1) and "other" (line 2) stresses the difference between the transactions of financial intermediaries (mainly central and commercial banks, and the U.S. Treasury) and those of the "customers" financed by them. Money market assets are the sum of official monetary reserves and commercial banks' claims on foreigners. Money market liabilities are the sum of foreign official assets in the United States and of the U.S. Treasury securities and the other liabilities reported by U.S. banks. To facilitate reconciliation with standard estimates of the U.S. balance of payments, however, I have included under these money market liabilities the small amounts of "contingent" liabilities arising from SDR allocations, and of Treasury securities and bank claims held by nonbanks as well as banks. "Other" (than money market) assets and liabilities (on line 2) are the total of all other foreign assets and liabilities. They used to be mostly the sum of direct and portfolio investments, and of relatively small amounts of assets and liabilities reported by nonbanking concerns and of errors and omissions. These errors and omissions, however,—now relabelled "statistical discrepancy"—rose by $121 billion in the last four years to a cumulative total of $133 billion. It is generally agreed that they are in fact unrecorded inflows of speculative capital, but a minor portion of them—which I have not hazarded to guesstimate—might be deducted as due instead to unrecorded current account receipts.

One may derive from these Table 3 estimates a number of observations highly relevant both analytically and politically:

a) Note first the striking contrast between the 1950–69 and the 1970–78 capital inflows and outflows. The increases of liabilities over the years 1950–69 were relatively modest in size, averaging less than $5 billion a

year. Yet, their persistence was regarded as sufficiently worrisome both by the United States and by other countries to induce them to launch ambitious negotiations aiming at fundamental reforms of the "gold-exchange standard," or rather *"gold-convertible dollar standard,"* enshrined in the Bretton Woods Agreement. The abortion of these negotiations inexorably led to the 1971 collapse of the system.

b) These inflows and outflows were dramatically magnified—more than 10 times—over the following years:
   1) Capital inflows (the liabilities on line I) totaled more than $700 billion from 1970 through 1982, their yearly average rising from $32 billion in 1970–78 to $104 billion in 1979–82, and reaching a peak of $146 billion in 1982 alone;
   2) The bulk of these inflows were recycled abroad (see the assets' increases on line II), mostly by commercial banks whose foreign claims rose from a paltry $13 billion at the end of 1969 to more than $400 billion at the end of 1982, at an annual rate rising from $13 billion over the years 1970–78 to $68 billion in the following four years, including again a peak of nearly $110 billion in 1982 alone (line IIA 1, b).

c) The breakdown of these global capital movements between "money market" transactions (line 1) and "other" transactions (line 2) exhibits some sharp contrasts which explain the dramatic reversal of the dollar exchange rate from an *overdepreciation* until the end of the 1970s to an *overappreciation* in the following four years (see Section 5 below):
   1) "Other" (than financial intermediaries) net capital transactions, i.e., direct and portfolio investments, other nonbank capital transactions, and errors and omissions, switched from net *outflows* of $76 billion in 1970–78 to net *inflows* of $150 billion in 1979–82, average *outflows* of $8 billion a year being followed by average *inflows* of $38 billion, peaking to $68 billion in 1982 (line IIIA2).[6]
   2) This switch in customers' transactions, from outflows to inflows, was accompanied and partly financed by an opposite switch in money market net transactions from average *inflows* of $10 billion a year to average *outflows* of $25 billion, including peak outflows of $34 billion in 1982 (line IIIA, 1). Foreign countries' net assets in the U.S. money market, which had *risen* by $94 billion, from $19 billion at the end of 1969 to $113 billion at the end of 1978, have *dropped* precipitously since then by $99 billion to only $14 billion at the end of 1982. The continuation of this trend would require that the U.S. monetary authorities and com-

[6]These $38 billion and $68 billion capital inflow estimates would be reduced only moderately to about $30 billion and $50 billion respectively if one follows the suggestion of the Morgan Guaranty *World Financial Markets* (February 1984, p. 3) to attribute to the overestimation of the U.S. current account deficit, rather than to unrecorded capital inflows, one-fifth of the huge asymmetry in the published current account transactions for the world as a whole shown in the 1983 *Balance of Payments Statistics* of the IMF, volume 34 Yearbook, Part 2 p. xii.

mercial banks increase year after year their net lending to the rest of the world, and that other countries accept an annual increase in their net debt to the U.S. money market in order to finance their other, unrequited capital exports to it.

5. *Disequilibrating Impact of the "Dollar Exchange Standard" upon Nominal and Real Exchange Rates.*

a) The "gold convertible dollar-exchange standard" enshrined in the Bretton Woods system and the "inconvertible paper-dollar standard" which succeeded it both preserved the ability of the United States to escape very largely the balance of payments discipline normally imposed upon countries incurring persistent deficits on overall (current and capital) account. The gradual depletion of international monetary reserves entailed by such deficits forces these countries to accept, sooner or later, a readjustment of their "nominal" exchange rates, restoring the competitiveness of their currency in world trade.

Foreign deficits do not, however, impose such a readjustment on a country whose *national currency* is accepted by foreigners as a parallel *world currency*. The United States experienced *net* reserve losses of $25 billion between 1949 and 1969, (the first two columns of Table 3, line III A1,a) by increasing its reserve liabilities by $16 billion (line IA1) and losing only $9 billion of its gross reserve assets (line IIA1,a).

The growing overvaluation of a stable dollar rate finally led to its depreciation, and even overdepreciation, over the following years, its rate vis-à-vis the German mark, for instance, falling by 57 percent (from 4.00 to 1.7315 marks per $) between the inception of floating rates in September 1969 and the end of 1979. This was, however, followed by a spectacular 62 percent appreciation to an obviously overvalued rate of 2.8113 marks per $ in the closing days of January 1984 (still 30 percent below its 1969 rate).[7]

b) This renewed overvaluation of the dollar—estimated, or "guesstimated" at 32 percent in the January 1984 *Report of the Council of Economic Advisers*—emerges clearly from an even cursory examination of the U.S. balance of payment and capital investment estimates summarized in Table 4.

[7]These enormous fluctuations are, of course, drastically curtailed when attention is centered on a so-called "effective rate," averaging the dollar rate vis-à-vis a large number of currencies, including those of all the industrial or OECD countries, or those of an even larger number of countries including many less developed countries. This is of little relevance, however, to exchange market transactors interested only in the choice between the dollar and the few currencies able to appreciate in relation to it.

Table 4
Changes in $ Exchange Rates (in %) and in U.S. Foreign Income and Capital Accounts: 1950–1983 (average yearly flows, in $ billions)

	1950–82	1950–69	1970–82	1970–78	1979–82	Year 1982	Year 1983
I. $ Fluctuations (in %) vis-à-vis:							
German mark	−43	−5	−41	−54	+30	+5	+15
Swiss franc	−54	−	−54	−63	+23	+11	+11
Japanese yen	−35	−	−35	−46	+21	+7	−1
Gold	−98	−	−98	−85	−51	+20	+17
II. Income Accounts Balance[1]	+5	+6	+4	+5	+3	−5	−34
A. Earnings on Past Investments	+9	+4	+18	+13	+30	+27	+24
B. Other Current Transactions[1]	−4	+2	−14	−8	−27	−32	−58
III. Economic and Military Grants (−)	−4	−4	−5	−5	−5	−6	−7
IV. Valuation and Coverage Adjustments to Capital Accounts	−1	−1	−1	+1	−6	−18	n.a.
V. Adjusted Capital Accounts Balance[2] = II − (III + IV) = A + B	−	+1	−2	+1	−8	−29	−41
A. Foreign Aid Assets	+2	+1	+3	+3	+5	+6	+5
B. Other Net Assets	−2	−	−5	−2	−13	−34	−46
1. Money Market	−1	−2	−	−10	+25	+34	−40
2. Other	−1	+2	−6	+8	−38	−68	−6

[1]Including exports financed by economic *and military* grants.
[2]1983 estimates do not include valuation and coverage adjustments, not yet reported.
Source: See Appendix Tables A3 and A4

The huge fluctuations of the $ exchange rates vis-à-vis its main rival currencies, recorded under line I, obviously bear little or no relationship to the minor fluctuations of the U.S. *income accounts* balance, recorded on line II.[8] They are, instead, closely related to the huge fluctuations of the adjusted net capital accounts recorded on line VB2, i.e., excluding foreign aid and the money market financing of clients' capital transactions by financial intermediaries.

Three successive phases mark the 33 years covered by these estimates:

1) The dollar remained relatively stable over the 20 years from the end of 1949 to the closing months of 1969, the net yearly average of capital exports of banks' clients (line VB2) being approximately financed by the $ accumulation of financial intermediaries (line VB1). Yet, this continued accumulation, totaling $40 billion over the period as a whole, was regarded as excessive by foreign creditor countries, moving them to cease their unquestioned support of the dollar on the exchange market. Floating rates were adopted by more and more countries, and became the norm, rather than the exception, in March 1973.
2) The huge depreciation of the dollar in the following years is explained by the quadrupling of the yearly average of net capital exports from the United States, which passed from $2 billion to $8 billion (2nd and 4th columns of line VB2).
3) Its spectacular recovery over the years 1979–82 is due to the reversal of these movements. Capital *outflows* totaling $74 billion ($8 billion a year) were followed by *inflows* totaling $150 billion ($38 billion a year), including peak inflows of $68 billion in 1982.

   These outflows and inflows were largely financed—or even overfinanced at first—by opposite inflows and outflows of money market transactions, reducing in part the overappreciation of the dollar exchange rate.

c) Contrary to most economists' forecasts—including my own—this overappreciation continued, even more steeply, throughout 1983, reaching a peak in the first months of 1984. The impact of this overappreciation—undercompetitiveness—has been enormous. The current account balance of the United States, as usually measured by the *Survey of Current Business*, deteriorated from *minus* $11 billion in 1982 to *minus* $41 billion in 1983 and is officially forecast to reach *minus* $80 billion this year. The merchandise balance moved from *minus* $36 billion in 1982 to *minus* $61 billion last year and is officially forecast at *minus* $110 billion this year (see Synopsis Table C above). This is clearly untenable for U.S. firms exposed to foreign competition at home as well as abroad. It is unleashing enormous pressures for protectionist restrictions, mostly resisted so far by the Administration. Such measures might reduce imports, but not exports,

[8]Nor to those of the current account balance as usually defined, i.e., excluding exports financed by economic and military grants.

which would decline even further, on the contrary, as a result of foreign retaliation.

All policymakers thus pray for substantial declines in the dollar rate vis-à-vis the German mark, the yen, the Swiss franc, etc., essential to restore U.S. competitiveness in world trade. But when and how? Barring massive official interventions in the exchange market (on a scale hardly to be expected from either the United States or foreign countries), the only possible answer lies in a reversal of the speculative capital flows which still push the dollar upward under today's floating exchange rate system.

The likelihood and timing of such a reversal obviously depend on an abatement of the capital flows' root causes. What are they?

1) The one most frequently mentioned, and deplored, is the high level of interest rates flowing from record fiscal deficits and low savings in the United States, combined with the reluctance of the Federal Reserve to finance the former through inflationary levels of money creation.
2) As, or more, important are the fears of a third world war unleashed by the Iranian revolution and other political and military crises in the Middle East, Poland, and Central America. These fears have moved huge amounts of refugee capital from European havens to the United States.
3) A third cause is the initial confidence in President Reagan's proclaimed determination to combat inflation, and in his ability to do so more successfully than other countries. Capital will continue, of course, to move out of scores of inflationary countries, but need not for that reason move only toward the United States. A few other countries, such as Germany and Switzerland, may recover their traditional attractiveness in this respect, in view of both the current success of their anti-inflationary policies and, most of all, the unanimously forecast appreciation of their currencies vis-à-vis the dollar.

I would conclude that the two most durable factors in the continuing appreciation of the dollar on the exchange market are the fears of a third world war and the interest rate differentials between the United States and other major money markets. Nevertheless, net capital outflows from an increasing number of weaker countries are bound to dry up, in view of the near-exhaustion of the previously accumulated reserves and borrowing capacity of these countries. Even in those countries still able to sustain outflows, they contribute to stagflation (a) because of excessive rates of currency depreciation and consequent price increases, and (b) because investments in the United States compete with domestic investments, thereby reducing economic activity and employment at home. Some economists and policymakers therefore advocate capital controls. But their successful implementation would require joint action by several major countries, and the idea meets with obvious opposition from influential financial circles, and widespread skepticism about their feasibility.

If I were forced to hazard a reluctant guess, two reasons would incline me to foresee that the generally desired depreciation of a vastly overvalued dollar may not be too far off.

The first reason is the drying up of the OPEC surpluses which contributed so hugely to the flood of foreign capital to the United States following the two explosions of oil prices. These surpluses dropped from $65 billion in 1981 to $18 billion in 1982, and switched into rising deficits last year, mainly because of lower oil prices and the curtailment of production, aimed at avoiding even steeper price declines.

The second reason is the continued likelihood of a banking crisis. U.S. bank claims abroad totaled more than $400 billion at the end of 1982, and were still rising in 1983, although at a sharply reduced annual rate of only $25 billion compared to more than $109 billion in 1982. A substantial portion of these claims is held in countries such as Mexico, Brazil, Argentina, and a large number of others whose liquidity, if not solvency, raises increasing concern today. The exposure of other countries' banks to debtors' default— open or concealed in various ways—is also disquieting, although in a lesser degree.

Renewed exchange crises of serious magnitude thus loom on the horizon and might strengthen the incipient, but spectacular, interest now shown by the market for ECU investments as an important adjunct and alternative to dollar investments. This brings me to the second part of my paper: the prospects for the ECU in the European and in the world monetary system of tomorrow.

II. An ECU-Anchored European Monetary Area as Harbinger of a Decentralized World Monetary System

1. *Introductory Remarks*

The creation of the *European Monetary System (EMS)* was prompted by two very different, but converging, objectives:

1. in the short run, the desire to make the national economies of the member countries of the European Community less dependent on the vagaries of an unstable paper dollar;
2. in the longer run, the desire to progress toward a full economic, monetary, and therefore political union of the Community.

Three successive sessions of the *European Council* of the Heads of State or Governments—at Copenhagen, on April 7th and 8th, at Bremen, on July 6th and 7th, and at Brussels, on December 4th and 5th—defined the broad lines of the initial system put into operation on March 13, 1979. Its later evolution, however, was referred to only very briefly in Annex 5 to the "Conclusions of the Presidency of the European Council" at Bremen,[9] and the paragraph A14 of the "Resolution of the European Council" at Brussels,[10] foreseeing the creation, within two years, of a *European*

[9]"Not later than two years after the start of the scheme, the existing arrangements and institutions will be consolidated in a European Monetary Fund."

[10]"We remain firmly resolved to consolidate, not later than two years after the start of the scheme, into a final system the provisions and procedures thus created. The system will entail the creation of a European Monetary Fund...as well as the full utilization of the ECU as a reserve asset and a means of settlement."

Monetary Fund. The implementation of this decision was, moreover, relegated to "an opportune moment" by the European Council held at Luxembourg in December 1980.

This might confirm the pessimism of those who regard the European monetary system as a "tombstone" rather than a "cornerstone." History teaches us, however that the most crucial reforms of the *international* monetary systems as well as of *national* monetary systems, have already been determined, with very rare exceptions, by the private sector of the economy rather than by the governments and their bureaucracies.

On the national level, for instance, the replacement of gold and silver moneys by fiduciary money cannot be credited—or debited?—to official initiatives, such as the French "assignats," soon bound to bankruptcy, but to the spectacular development of currency notes and bank deposits in the XIXth century. By 1913 these constituted about 85 percent of world money supplies, but it took another 35 years for the French and Italian monetary authorities, for instance, to include checking deposits in their official monetary statistics.

As for the international monetary system, the *gold standard* originated in England from a 1696 law aiming to consolidate the *silver standard*, but at an official rate overvaluing gold in relation to silver and making silver, therefore, more attractive as a commodity than as circulating money. Similarly, the collapse of the Bretton Woods *gold exchange standard* was certainly not intended by the authorities. When they belatedly resigned themselves to debate reforming a system whose breakdown had become unavoidable, they repeatedly proclaimed that they would examine all possible reforms, except two: fluctuating exchange rates and any change in the price of gold. They unanimously regarded the stability of exchange rates and of the price of gold—at *$35 per ounce*—as the two unshakable pillars of any international monetary system, present or future! Any comments would be superfluous and unkind.

I shall therefore turn to market developments as a better guide to the forecasting of an uncertain future, and to any policy that may reverse the disastrous course of events in which we have all been engulfed for more than a decade already.

2. *Spectacular Growth of ECU Transactions in the Private Market*

The first years of the 1980s decade have witnessed a spectacular growth in the private use of the ECU, overtaking and stimulating the slower progress of the official authorities toward its development, not only as a unit of account, but as a full "parallel" currency in international settlements, investments, and working balances, outside as well as within the European Community.

Currency speculators will of course continue to prefer a basket of their own making, centered on the currency, or currencies, which they expect to appreciate, and excluding those which they expect to depreciate. Exchange gains or losses may be largely offset, however, or more than offset, by interest rate differentials. There were no exchange rate realignments, for instance, in

the second half of 1983, and the slight appreciation of the mark on the market (0.3 percent) was far more than offset by interest rate differentials of about 4 percent a year between one month ECU and one month mark deposits.

Even more important, of course, is the fact that speculators trusting their own judgment or that of their advisers lost heavily on their dollar investments over the years 1971–78, and on their Swiss franc or German mark investments in the following years.

Dollar investments have certainly proved far more remunerative than ECU investments over the last few years, but the opposite seems probable in the near future, since the forecast depreciation of an overvalued dollar far exceeds in percentage terms any chances of further appreciation, except in the event of a third world war. The ECU should, therefore, be far more attractive to all risk-averters, and particularly to company treasurers whose exchange losses expose them to far greater criticism from their boards and shareholders than their failure to maximize exchange gains.

This explains the fast growing use of the ECU in the Eurobond and Euromoney markets.

ECU flotations on the Eurobond market have grown from a mere 224 million in 1981 to more than 2,600 million in 1983 and a yearly rate of 3,600 million in the first quarter of this year. They totaled about 4.7 billion by the end of 1983 and 5.6 billion in March 1984. The ECU share in public market flotations is still extremely modest, but has risen more than 14 times over three years, passing from 0.3 percent in 1980 to 4.8 percent in the first quarter of 1984, and from 8th to 3rd place, immediately after the dollar (80 percent) and only insignificantly below the German mark (4.8 percent).[11]

[11]See Tables 5 and 6; and the monthly articles of Pierre Guimbretiere in *Eurépargne* (Luxembourg) 1984.

Table 5
ECU Bond Issues: 1981 – March 1984

	World Total	Within EEC						Outside EEC				
		Total	Institutions	Countries				Total	Canada	U.S.	Japan	Other[2]
				Total	Italy	France	Other[1]					
Number of Issues:												
Period: 1981	6	5	3	2	2	–	–	1	1	–	–	–
1982	*17*	*13*	*3*	*10*	*3*	*7*	–	*4*	*1*	*1*	–	*2*
1983	36	25	7	18	1	9	8	11	1	1	2	7
1984 January–March	16	8	3	5	–	2	3	8	1	3	1	3
Yearly rate	(64)	(32)	(12)	(20)	–	(8)	(12)	(32)	(4)	(12)	(4)	(12)
Cumulative, end of: 1981	6	5	3	2	2	–	–	1	1	–	–	–
1982	23	18	6	12	5	7	–	5	2	1	–	2
1983	59	43	13	30	6	16	8	16	3	2	2	9
March 1984	75	51	16	35	6	18	11	24	4	5	3	12
Amounts (ECU millions)												
Period: 1981	244	204	139	65	65	–	–	40	40	–	–	–
1982	1,810	1,690	150	1,540	1,240	300	–	120	50	15	–	55
1983	2,607	2,042	550	1,492	600	587	305	565	50	40	80	395
1984 January–March	906	545	210	335	–	110	225	361	85	96	40	140
Yearly rate	(3,624)	(2,180)	(840)	(1,340)	–	(440)	(900)	(1,444)	(340)	(384)	(160)	(560)
Cumulative, end of: 1981	*244*	*204*	*139*	*65*	*65*	–	–	*40*	*40*	–	–	–
1982	2,054	1,894	289	1,605	1,305	300	–	160	90	15	–	55
1983	4,661	3,936	839	3,097	1,905	887	305	725	140	55	80	450
March 1984	5,567	4,481	1,049	3,432	1,905	997	530	1,086	225	151	120	590

[1]The Netherlands, United Kingdom, Ireland, Denmark, Belgium, Germany.
[2]World Bank, Council of Europe, Sweden, Australia, South Africa.
Source: *ECU Newsletter*, No. 1–8, February 1982–March 1984, Istituto Bancario San Paolo di Torino.

Table 6
Currency Denomination of Euro-bond Issues (%)

Year	SDR	ECU[1]	U.S. Dollar	Deutsch-mark	British Pound	Other Currencies
1980	0.2	0.3	68.5	15.0	4.1	11.9
1981	1.4	1.0	84.9	4.0	1.6	7.1
1982	0	3.8	85.1	5.0	1.4	4.6
1983	0	4.2	79.2	7.9	4.0	4.7
Jan.-March 1984	0	4.8	80.3	4.8	7.0	3.0

[1]Former equivalent "Unit of Account" in 1980.
Source: *World Financial Markets*, March 1984, p. 11

Bank and savings deposits in ECU are fast growing in number (several thousands) and amount, and bank loans denominated in ECU were estimated to total about 10 billion ECUs at the end of 1983. A bank syndicate has just announced that the setting-up of a company to issue travelers checks in ECU is now at hand. A number of multinational firms have also started to use the ECU for the denomination of their internal accounts and external contracts. International insurance, airline, and shipping firms are particularly attracted by the use of the ECU in their operations.

ECU settlements were initially handicapped by the fact that actual drawings by the payer could take place only in national currencies that had to be reconverted into ECU by the payee, unnecessarily entailing a double series of exchange costs on the transaction. A number of major banks have now overcome this handicap by opening mutual settlement accounts for the clearing of ECU transactions among themselves and for correspondent banks.

A further major step is expected to be taken within a few months with the organization of a broader clearing structure, under the prestigious and impartial aegis of the Bank for International Settlements acting as agent for a larger number of clearing banks.[12]

3. *Prospective Evolution of the EMS towards Economic and Monetary Union*

The ultimate fulfillment of repeated summit meetings' promises of an *Economic and Monetary Union* of the European Community countries can only be deemed a distant hope at best. As long as member countries fail to harmonize their inflation rates, exchange rate realignments will remain unavoidable between the stronger and the weaker currencies, as the only way to preserve the minimum goals of free trade for manufacturers and of a still imperfect common market for agriculture within the customs union of the

[12]See particularly the papers on the private use of the ECU, in a debate that took place in Paris, June 10, 1983, under the sponsorship of the "Groupement pour la Coopération Monétaire Européene," and the address by A.L. Swings on "ECU and SDR Banking Practices, Yesterday, Today and Tomorrow" at the Conference on Composite Currencies, Financing, Accounting and Invoicing, London, 26-27 April, 1983.

Community.

Progress toward a fuller use of the ECU in the Eurocurrency market, in which European banks now hold the equivalent of about $850 billion to $900 billion (thousand million) of assets and liabilities in currencies other than their national currencies, should however elicit enthusiastic support from all sides of the political spectrum. The anti-European nationalists obdurately oppose, of course, the substitution of the ECU for their national currency in *domestic* transactions, but would be delighted to see it replace foreign currencies, such as the dollar, the Swiss franc, the mark, etc., in *international* accounts and transactions.

The economic arguments for the further development of a European Monetary System anchored on the ECU rather than on the wildly fluctuating paper dollar are even more incontrovertible. Since you might deem me to be biased in this respect, let me quote from a recent lecture of Professor Henry C. Wallich, member of the Board of Governors of the Federal Reserve System:[13]

> As an example of monetary-policy cooperation, this [the EMS] is at least a partial success story and, unfortunately, one of the not many that I have been able to refer to in this paper....
>
> In a world in which exchange-rate movements have become extremely large, movements within the EMS have remained small relative to fluctuations of outside currencies. While outside currencies have over- and undershot purchasing-power-parity levels by wide margins, relative purchasing-power parity has been very roughly maintained in the EMS. And while outside currencies have often experienced sharp reversals, movements within the EMS have generally been in the direction of better adjustment, and without reversals except for some recent small revaluations of previously devalued currencies....
>
> While the EMS currencies have not enjoyed the complete stability that some expected of the system, they have had the relative stability of a moderately predictable jumping peg, with respect to each other. Contrasted with the wide moves against outside currencies and among those outside currencies, there may have been benefits from this form of "stability."

The eight exchange rate realignments that have intervened so far between member currencies have all been agreed to jointly, as is made *operationally* imperative and unavoidable by the fact that any currency appreciation or depreciation is expressed in relation to the ECU basket, i.e., to a weighted *average* of all the member currencies of the system. None can appreciate, therefore, or depreciate, in terms of this average, without simultaneous depreciation, or appreciation, of some other. Moreover, these realignment agreements have not merely endorsed—as used to be the case in the IMF—the initial request of the country wishing for a change in its own exchange rate. They have often been modified and influenced by the views of the partner countries desirous to minimize—or, occasionally enlarge—the scope of these realignments.

[13] "Institutional Cooperation in the World Economy," University of Chicago, May 5th, 1983.

A greater contrast could hardly be imagined between these concerted readjustments, on the one hand, and on the other the erratic, daily, fluctuations of the dollar—and other nonmember currencies—most often prompted by speculative capital movements; and in which offsetting or aggravating official interventions by the authorities, if any, rarely reflect joint Community decisions. This is bound to be a major political argument favoring a further strengthening of the present EMS.

Tables 7 and 8 document Governor Wallich's observations about the comparative fluctuations of "nominal" and "real" exchange rates, within and outside the EMS. Table 7 shows that fluctuations of members' currencies vis-à-vis the ECU have been a mere fraction of the corresponding fluctuations of nonmember currencies. The first two lines of Table 8 show that "nominal" exchange rate fluctuations within the EMS have largely offset divergencies in inflation rates, thus preserving a remarkable stability between "real" (competitive) exchange rates, or restoring it for the Belgian franc and the Italian lira. (The franc entered the system in March 1979 at an obviously overvalued or undercompetitive rate, and the lira at an undervalued or overcompetitive one.)

Table 7
Cumulative Exchange Rate Appreciation (+) or Depreciation (−) vis-à-vis the ECU since March 13, 1979 (in percent)

	1979		1981		1982		1983	
	Sept. 24	Nov. 30	March 23	Oct. 5	Feb. 22	June 14	March 21	May 18
SDR	−2.59	−3.82	+6.75	+11.15	+15.56	+18.42	+21.81	+23.72
U.S. Dollar	−4.21	−5.35	+11.42	+23.80	+30.82	+38.15	+45.02	+46.92
Japanese Yen	−10.14	−20.79	+11.42	+12.98	+17.31	+15.37	+26.66	+31.91
German Mark	+1.01	+1.15	−1.35	+4.18	+3.82	+7.58	+13.34	+11.99
French Franc	−0.97	−0.83	−3.29	−6.09	−6.41	−12.33	−14.64	−15.66
Italian Lira	−0.97	−0.83	−9.09	−11.72	−12.03	−14.97	−17.21	−18.19
Belgian-Luxembourg Franc	−0.97	−0.83	−3.29	−3.19	−11.72	−12.26	−11.06	−12.12
Netherlands Guilder	−0.97	−0.83	−3.29	+2.14	+1.79	+5.47	+9.01	+7.71
Danish Krone	−3.80	−8.25	−10.52	−10.43	−13.41	−13.94	−11.91	−12.96
Irish Punt	−0.97	−0.83	−3.29	−3.19	−3.51	−4.11	−7.59	−8.69
U.K. Pound	+2.07	+2.21	+22.34	+10.34	+19.07	+18.34	+5.30	+12.97
Swiss Franc	+2.27	−1.24	−1.79	+9.50	+17.34	+12.66	+17.74	+20.62

Table 8
Cumulative Changes in Nominal Exchange Rates, Consumer Prices, and Real Exchange Rates vis-à-vis EMS Competitors[1]

	France	The Netherlands	Denmark	Germany	Belgium	Italy	Switzerland	Japan	United Kingdom	United States
I. Competitiveness Changes										
A. Under EMS-: to 1st quarter 1983										
1. Nominal Exchange Rates	−10.4	+9.9	−15.2	+18.7	−11.7	−13.8	+20.5	+24.6	+10.9	+44.6
2. Inflation Rates	+11.7	−11.1	+14.2	−20.3	−4.4	+44.9	−14.1	−16.2	+9.7	−1.4
3. Real Exchange Rates	+0.1	−2.3	−3.2	−5.3	−15.6	+25.0	+3.4	+4.4	+21.6	+42.7
B. Before EMS: 1970 to 1st quarter 1979 Real Exchange Rates	−4.0	+17.6	+6.7	+8.0	+9.4	−27.1	+39.4	+33.8	−16.5	−36.8
II. Changes in Real Exchange Rates Under EMS										
1979: 3rd quarter	+1.0	−2.8	+3.4	−1.6	−2.4	+5.3	−0.7	−10.3	+15.9	+0.5
4th quarter	+2.0	−3.2	+0.9	−2.1	−3.4	+6.6	−3.5	−19.6	+10.8	−0.7
1981: 1st quarter	+7.0	−5.2	−0.8	−7.3	−5.5	+18.0	−7.6	+6.1	+45.9	+19.8
4th quarter	+6.2	−3.5	+0.6	−8.1	−7.5	+15.0	+4.2	+4.0	+34.7	+32.6
1982: 1st quarter	+6.4	−3.8	−2.0	−7.5	−11.8	+17.1	+5.8	+3.0	+38.3	+37.6
2nd quarter	+6.1	−2.1	−2.2	−5.7	−14.2	+16.6	+2.4	+0.7	+39.0	+41.2
1983: 1st quarter	+0.1	−2.3	−3.2	−5.3	−15.6	+25.0	+3.4	+4.4	+21.6	+42.7

[1]Lines IA 1 and 2 show changes in *nominal effective* exchange rates and in consumer prices measured in national currencies, in relation to corresponding EMS weighted averages. All other estimates (arrived at by multiplying indices of relative exchange rates by indices of relative consumer prices) reflect the changes in *real* exchange rates, after exchange rate adjustments, *plus* signs indicating relative price increases *(decreased competitiveness)* and *minus* signs relative price declines *(increased competitiveness)*. Line IB shows changes from 1970 to the first quarter of 1979, and all other lines changes from the first quarter of 1979 (initiation of EMS) to the quarters in which central rates of EMS currencies were realigned.

However, this "partial success story"—to quote again from Governor Wallich—is to be explained in part by the strength of the dollar vis-à-vis the mark throughout most of the EMS years. This has eased the exchange rate tensions between the stronger and weaker currencies within the Community. The expected strengthening of the mark vis-à-vis the dollar will accentuate these tensions and make the functioning of the EMS more difficult, as well as more necessary than ever.

The Commission of the European Communities is keenly aware of this problem and has proposed to the Council a variety of measures to be gradually implemented in the very near future:

a) Using the ECU in preference to national currencies in the accounting and financial transactions of the Communities, including their resort to the capital market.
b) Granting the ECU a uniform "foreign currency" status, thus enlarging its use in all member states for the denomination of private capital movements, which are today still contracted predominantly in dollars, Eurodollars, and a few other Eurocurrencies. This would require, particularly, a change in German regulations, which still improperly apply to the ECU a legal prohibition against "indexation clauses," in spite of the fact that it has developed into a real currency, and is no longer a mere "unit of account" justifying this initial interpretation of the German law.
c) Privileged access to the ECU market for residents of countries with exchange control legislation.
d) Promulgation of a document defining a uniform ECU status throughout the Community, stating clearly the rules which users have to follow and protecting the ECU trademark.[14]

The progress of the EMS towards its proximate objective of making the ECU the major "parallel" currency of the Community countries in their external transactions—and its ultimate objective of enlarging ECU use to a growing category of domestic transactions—will still have to overcome the understandable concern of central banks, particularly the Bundesbank and the Nederlandsche Bank, about two interrelated dangers. These are the inconvertibility of the ECU into third currencies, and the danger of inflationary abuses of its issues by the FECOM (European Monetary Cooperation Fund), or the European Monetary Fund (best rechristened the "European Federal Bank")—initially expected to replace the FECOM in March 1981, but later postponed sine die by the European Council of Ministers.

4. *Convertibility of the ECU*

Frequent misapprehensions in some circles should first be dispelled by emphasizing that the ECU has remained, since its inception, fully convertible for the settlement of deficits outside as well as within the Community. Outside deficits are settled nearly exclusively in dollars, and entail a reduction *pari passu*:

[14]See the editorial of F.X. Ortoli in the *ECU Newsletter* of the Istituto Bancario San Paolo di Torino, May 1983.

—of the 20 percent of gold and dollar reserves held with the FECOM;
—of the 80 percent of gold and dollar reserves held outside the FECOM.

The external convertibility of these two types of reserve assets is therefore *legally* identical, and the so-called "pooling" ("mise en commun") of reserves held with the FECOM does *not* allow any country to draw down the reserve assets of any other country. The depletion of a deficit country's reserves may force it eventually to devalue its currency if it does not adopt in time the measures necessary to readjust its balance of payments, but other countries' reserves are totally unaffected by this.

While this *automatic* convertibility does not apply to the ECUs issued to finance member countries' market interventions, such issues have remained nil or minimal so far. (See last column of Table 9.) Nor should they grow excessively if the rules suggested below are implemented. The FECOM's ECU 54 billion gold and dollar assets should enable it to meet also the same 20 percent of ECU creditors' conceivable external deficits.

What is true is that the legal convertibility of ECU reserves into dollars does not guarantee the stability of the dollar exchange rate vis-a-vis the ECU, any more than vis-à-vis the national currency of any member country. The appreciation or depreciation of dollar rates will be determined for the ECU basket as well as for its component currencies by the factors amply discussed above in the first section of this paper. A further strengthening, rather than weakening, of the EMS joint policies and institutional arsenal would obviously enable member countries to combat more effectively the $ exchange rate fluctuations, up and down, which member countries deem detrimental to their interest, and in any case to preserve a greater stability of the intra-Community exchange rates far more important to them than the $ rate.

5. *Safeguards against Inflationary ECU Issues*

The danger of *inflationary ECU issues* is undoubtedly real: they have doubled indeed over five years, passing from 26 billion to nearly 53 billion, (first and fourth lines of first column of Table 9).

The first and most urgent reform obviously called for is to eliminate what has been the overwhelming cause, i.e., the automatic increases or decreases in ECU issues flowing automatically and haphazardly today from wild fluctuations in the contractual rate at which gold "swaps" are converted into ECUs. These account for 92 percent of the global increase just mentioned. The rise of the contractual conversion rate of gold in ECUs (identical to or lagging slightly behind its market prices) from the initial 165 ECU per ounce to 451 resulted in a 25 billion increase in the ECU counterpart of FECOM gold assets, which were nearly unchanged in volume.

Note also that this cumulative increase of 25 billion was subject to enormous variations, up and down:

—a 24 billion expansion (171 percent) from 14 billion initially to a first peak of 38 billion in January 1981;
—a subsequent 10 billion decline (27 percent) to a low of 28 billion in July 1982;

Table 9
ECU Issues and Counterpart Assets
(ECU Billions)

I. At end of:	Total (a=b+c)	Gold (b)	Credits		
			Total (c=d+e)	To United States (d)	To Member Countries (e)
A. At Current Rates					
April 1979[1]	26	14	12	12	0
January 1981	51	38	13	11	2
July 1982	40	28	12	10	2
April 1984	53	39	14	13	1
B. At Initial Rates					
April 1979[1]	26	14	12	12	0
January 1981	27	14	12	11	2
July 1982	23	14	9	7	2
April 1984	24	14	10	8	1
II. Value changes, from	+27	+25	+2	+1	+1
April 1979 to January 1981	+25	+24	+1	−1	+2
January 1981 to July 1982	−11	−10	−	−1	−
July 1982 to April 1984	+13	+11	+2	+2	−1
A. Volume Changes, from	−2	−	−2	−4	+2
April 1979 to January 1981	+1	−	+1	−1	+2
January 1981 to July 1982	−3	−	−3	−3	−
July 1982 to April 1984	−	−	−	−	−
B. Price Changes,[2] from	+28	+25	+3	+3	×
April 1959 to January 1981	+24	+24	−	−	×
January 1981 to July 1982	−7	−10	+3	+3	×
July 1982 to April 1984	+13	+11	+2	+2	×

[1]April 1979 estimates include UK gold and dollar deposits, made only in July, at the April gold and dollar conversion rates of other deposits.
[2]Price changes (i.e., changes in gold and dollar rates vis-à-vis the ECU) are obviously nil for credits to member countries denominated in ECUs.

—a renewed 13 billion expansion (47 percent) to 41 billion in October 1983;

—a decline of 2 billion (5 percent) to 39 billion in April 1984.

Such absurd fluctuations in ECU issues should be avoided through the "sterilization" of bookkeeping gold profits and losses in special, "frozen" accounts on which drawings would be authorized only as an alternative to borrowings from the FECOM, and under the same conditions, or for the repayment of such borrowings.

The adoption of this first measure is indispensable to enable the monetary authorities of the Community to adjust ECU issues to the financing requirements of potential, noninflationary growth in the volume of trade and production. To guard against possible abuses, a *presumptive ceiling* of x percent per year should be imposed by the European Council. Issues exceeding this ceiling might occasionally prove justifiable in exceptional circumstances ("force majeure," or "act of God"), such as the past explosions of oil prices, but would require qualified voting majorities of 2/3, 3/4, or even more, depending on their amplitude.

The *global* definition of this ceiling would impose *operationally* upon the authorities an explicit choice between the financing of credits to member countries and external investments—only dollars today—which are the counterpart of ECU issues. This would be both economically desirable and politically feasible, since balance of payments surpluses increasing the issue of ECUs against deposits of dollars—and other agreed-on currencies?—should normally reduce member countries' credit needs, while on the contrary these needs would normally increase—and be more compelling politically—when external deficits decrease the amount of ECUs issued in exchange for foreign currencies.

Opponents of the EMS constantly reiterate their fears and warnings about the likelihood of excessive credits to its more lax member countries, imposing additional inflationary pressures on the others. This has certainly not been the case in its first five years of operations. Credits to members (last column of Table 9) have remained extremely moderate, and often nil because promptly repaid by debtors. They accounted, at the end of April 1984, for only 2.5 percent of total ECU issues, while credits to the United States accounted for 24 percent (10 times more) and gold holdings of 73 percent. The ceiling proposed above should therefore be politically acceptable to all member countries, and eliminate all fears, unjustified *in the past*, of *future* abuses of its credit facilities.

As long as countries fail to harmonize their domestic policies sufficiently to avoid persistent divergences in their inflation rates, these divergences will continue to be sanctioned by periodic realignments of exchange rates. Any country—whether in surplus or in deficit—deeming such a realignment preferable to excessive credit extensions should receive the benefit of the doubt whenever its central rate clearly appears commercially overcompetitive or undercompetitive.

On the other hand, the countries opposed to such a realignment should also receive the benefit of the doubt whenever the strength or weakness of a

currency on the exchange market is due primarily to speculative capital movements. One should explore in this case the possibility of avoiding unnecessary and disequilibrating exchange rate realignments through a variety of measures aiming to deter such speculation—bullish as well as bearish—notably through a better coordination of interest rates, and even possibly through an "interest equalization tax," as the United States did in 1963.

This exploration should take fully into account the *geographic constellation* of these capital movements, largely due today—as amply demonstrated above—to enormous, undesirable and disequilibrating capital movements between the United States and the rest of the world, including the European Community. A more effective coordination of Community countries' policies regarding national interventions on the dollar exchange market and negotiations with the United States about exchange rates, interest rates, etc. is particularly necessary in this respect.

Within the Community, deficit countries should moreover consult their partners concerning their resort to international credit, including their borrowings on the market and from foreign official agencies as well as from the FECOM. Similarly, the surplus countries should submit to the examination of the Community the manner in which they finance their surpluses by the extension of credits—particularly their central bank's accumulation of foreign exchange—to their EC partners, the United States, and other countries. The "imported inflation" of which they have a right to complain may indeed often be due to an excessive financing of countries other than their Community partners!

III. Summary and Conclusions

1. The acceptance of the dollar as the main "parallel currency" of the world in international payments and reserve accumulation, official and private, is the main explanation of:

a) the forced suspension of its convertibility in August 1971, 40 years, nearly to the day, after the suspension of convertibility of the main previous "parallel currency," the pound sterling, in September 1931;

b) the worldwide monetary inflation resulting from the fantastic accumulation of international dollar reserves by foreign central banks and commercial banks;

c) the ability of U.S. banks to increase their foreign lending from about $1 billion a year in 1950–69, to an annual average of $68 billion in 1979–82, peaking to $109 billion in 1982, to a total cumulative level of more than $400 billion, which belatedly raises growing concern about the liquidity, if not solvency, of the borrowing countries.

Further inflows of foreign capital into the U.S. money market have been triggered additionally in recent years by fears of a third world war and by the rise of real as well as nominal interest rates prompted by unprecedented fiscal deficits and low saving rates in the United States. This has depleted the *net*

reserves of foreign countries in the U.S. money market from $113 billion at the end of 1978 to only $14 billion at the end of 1982, while provoking at the same time a switch from a previously undervalued dollar to a vastly overvalued (undercompetitive) dollar vis-à-vis its main rival currencies in world trade and finance.

These capital movements and exchange rate fluctuations bear little or no relationship to balance of payments disequilibria on current account between the United States and the rest of the world. The huge deterioration of the U.S. merchandise account—officially expected to close with a *deficit* of about $70 billion in 1983 and $110 billion this year—is obviously unbearable to the U.S. firms exposed to foreign competition at home as well as abroad. It can be corrected only by drastic protectionist measures and/or a sharp depreciation of the overvalued dollar.

2. Dangerous exchange rate and bank crises thus loom on the horizon. They should accelerate the spectacular development of the incipient ECU as an alternative "parallel currency" for the countries of the European Community and many others.

In the private market, the ECU has moved rapidly from 8th to 3rd place in public Eurobond flotations, and is used increasingly today not only as a unit of account, but as a real currency in transfers and payments.

The official authorities of the Community are now seeking to encourage this development of the ECU system, in order to protect, as far as possible, economic stability and growth from the disastrous impact of huge fluctuations in U.S. exchange rates and interest rates. They have unfortunately made little or no progress so far toward the promised elimination of the excessive divergences between national inflation rates, which is an indispensable prerequisite to the achievement of their ultimate objective of full economic and monetary union. As long as they do not succeed in this ambitious and politically difficult task, exchange rate realignments will remain unavoidable.

Yet, even as it now functions, the EMS is a remarkable "success story." All exchange rate realignments between participating currencies have been effected relatively smoothly and by unanimous agreement, after quick but meaningful consultations. They have, moreover, been limited to a fraction of dollar fluctuations imposed by the capital market, with little or no effective consultations between the authorities of the Community and of the United States. Finally and mostly, they have preserved or restored "real" exchange rates (competitiveness), by compensating for national inflation divergences that proved politically unavoidable.

A fuller acceptance of the ECU by the monetary authorities of all member countries will still require, however, fundamental changes of policies and institutions, guaranteeing the ECU against inflationary abuses of its issue power, and against the erratic impact imposed upon it, under present rules of operation, by the instability of speculative gold prices on the private market.

This acceptance should make politically feasible the implementation of other fundamental reforms of EMS, foreseen at the 1978 meeting of the European Council at Bremen, including the gradual conversion of the *FECOM* into a *European Monetary Fund,* better relabeled *Federal Reserve Bank of Europe.*

3. Forward-looking statesmen are already well aware of the need to move in this direction as rapidly as possible. But even politicians, concerned with their reelection, will accept it if and when excessive procrastination threatens the very survival of the Common Market itself. They know that public opinion will not accept the demise of an experiment whose success is as fantastic as obvious. Economically, it has helped bring the GNP per capita of most European countries from a mere fraction of that of the United States to approximate equality with it. Politically, it has removed from the horizon what was the nightmare of my generation, and of that of my parents and grandparents: the specter of a devastating Franco-German war. As Jean Monnet used to say, politics is not merely "the art of the possible." It is also "the art of making possible tomorrow what seems impossible today!"

Statistical Appendix

Note on Recalculation of the *International Financial Statistics* Tables on International Reserves

I *ASSETS,* measured in SDRs, with gold at 35 per ounce and the $ equal to the SDR, are taken from the latest *IFS* source available, i.e.:

a) the March 1984 issue of *IFS* for the 1978–1983 estimates;
b) the 1983 *IFS Yearbook* for the 1969 and 1972 estimates;
c) the 1979 *IFS Yearbook* for the 1949 estimates.

These estimates are modified in my tables:

1. In order to include a) *under gold,* b) at *35 per ounce,* the gold holdings (initially negative) of European institutions (only the FECOM and the Bank for International Settlements today, but also the European Fund in 1969)[15] whose ownership is retained by the depositing countries under quarterly swap arrangements. These are included in the main *IFS* tables as *foreign exchange,* rather than gold, and at *market prices,* rather than at 35 per ounce.
   This entails the following corrections:
   a) The inclusion under countries' "*gold*" of the difference between the *IFS* estimates of world gold and of IMF gold, valued at 35 per ounce (on lines 001 and 992 of the first bottom paragraph of p. 42 of the March 1984 *IFS,* and of the corresponding lines of the 1979 and 1983 *Yearbooks*). In my regional breakdown, this difference is included under "Industrial countries other than the United States."
   b) The deduction from *All Countries' Total Reserves* (line 010 of *IFS*) of the "revaluation" of European gold holdings, i.e., of the excess of their measurement at market prices over their measurement at 35 per ounce (lines 977 and 993 of the second and first bottom paragraphs, respectively, on p. 42 of the March 1984 *IFS*).
   c) The deduction from reported *Foreign Exchange* assets of industrial countries other than the United States (lines 110 *minus* 111) and of all countries (line 010), of these European institutions' gold, valued at market price (lines 997 and 993 of the second bottom paragraph of p. 42 of the March 1984 *IFS*).
2. In the regional breakdown of my tables, the addition discrepancy between the "All Countries" totals (line 010) and the sum of regional tables (lines 110, 999, and 201) are ascribed, on the advice of the Director of the IMF research department, to the "non-oil developing countries."
3. The regional breakdown of countries' gold is calculated residually by deducting from the "Total Reserves" of each regional group its "Total Reserves *minus* Gold," after the corrections mentioned above.

II *LIABILITIES,* measured in SDRs = dollars, are calculated as follows, for all countries and for regional groups:

1. *Concerted internationally* (the sum of):
   a) *SDR allocations* as reported in column (39) of the Fund Accounts (on p. 20 of the March 1984 *IFS,* and the corresponding column of the *Yearbooks* for earlier years);

[15]No longer reported but last shown on p. 7 of the July 1975 *IFS.*

b) *Liabilities to IMF* are reported "Use of Fund Credit" (on p. 28 of the March *IFS,* etc.) *plus* for 1969 the gold deposits and investments of the IMF with the United States (1,019 million) and the United Kingdom (40 million).

2. *Foreign Exchange:*
   a) The "*All countries*" total, as recalculated (see I, 1, c above) is debited exclusively to the industrial countries, under the assumption that holdings on nonindustrial countries are nil or insignificant.
   b) The *United States* is debited for the sum of:
      1) "Selected liabilities to foreign official institutions," reported on line 1 of Table 3.15 of the latest *Federal Reserve Bulletin*, converted from dollars into SDRs;
      2) "Liabilities of foreign branches of U.S. banks to official institutions," reported on line 60 of Table 3.14 of the same *Bulletin*, and similarly converted into SDRs.
   c) The difference between a) and b) above is debited to industrial countries other than the United States.
      Note that this procedure probably leads to a slight underestimation of U.S. liabilities, and a corresponding overestimation of other industrial countries' liabilities. My "guesstimated" U.S. liabilities are substantially lower than the "Eurodollar liabilities" estimates of the IMF, some of which are created by non-U.S. banks.

III *NET RESERVES* other than gold are equal to the gold transfers of countries to the IMF (valued at 35 per ounce) *minus* the undistributed IMF profits and, after 1980, minor accounting adjustments for "members' short-term borrowings under enlarged access policy," and for "borrowed reserves held in suspense." Again, I am indebted to Dr. William C. Hood, Director of the IMF research department, for this clarification.

IV *CORRESPONDING DOLLAR ESTIMATES*, at market gold prices and exchange rates are:

1. For *credit reserves:* SDR estimates, multiplied by the $-SDR exchange rate (penultimate line of bottom paragraph of p. 42 of March 1984 *IFS*).
2. For *gold reserves:* SDR estimates, multiplied by the market dollar price of an ounce of gold (first line of bottom paragraph of p. 42 of the March 1984 *IFS*) and divided by the 35 price used for SDR measurements.

Table A1
Gross and Net International Monetary Reserves: 1949–1983
(SDR and $ billions)

MEASURED IN SDRs[1]	End of Year	1949	1969	1972	1978	1979	1980	1981	1982	1983
I ASSETS		45.5	78.7	147.3	282.0	273.9	315.3	341.4	328.9	373.2
A. Credit Reserves		12.6	40.2	111.3	245.4	237.6	278.7	304.9	292.5	336.9
1. Concerted:		1.7	6.7	15.0	22.9	24.2	28.6	37.7	43.2	53.5
a) SDR Holdings		x	x	8.7	8.1	12.5	11.8	16.4	17.7	14.4
b) Res. Pos. in IMF		1.7	6.7	6.3	14.8	11.8	16.8	21.3	25.5	39.1
2. Foreign Exchange		10.9	33.5	96.3	222.5	213.4	250.1	267.1	249.3	283.3
3. Gold		33.0	38.5	35.9	36.6	36.3	36.6	36.6	36.4	36.3
II LIABILITIES (-)		−11.1	−38.6	−106.7	−242.1	−234.7	−275.9	−301.9	−290.1	−334.7
1. Concerted		−0.2	−5.1	−10.4	−19.6	−21.4	−25.9	−34.8	−40.7	−51.3
a) SDR Allocations		x	x	−9.3	−9.3	−13.3	−17.4	−21.4	−21.4	−21.4
b) to IMF		−0.2	−5.1	−1.1	−10.3	−8.0	−8.5	−13.4	−19.3	−29.9
2. Foreign Exchange		−10.9	−33.5	−96.3	−222.5	−213.4	−250.1	−267.1	−249.3	−283.3
III NET RESERVES		+34.4	+40.2	+40.5	+40.0	+39.3	+39.4	+39.5	+38.9	+38.5
A. Credit Reserves		+1.5	+1.7	+4.6	+3.4	+2.9	+2.8	+2.9	+2.5	+2.2
1. Concerted		+1.5	+1.7	+4.6	+3.4	+2.9	+2.8	+2.9	+2.5	+2.2
a) SDRs		x	x	−0.6	−1.2	−0.9	−5.6	−5.0	−3.7	−7.0
b) on IMF		+1.5	+1.7	+5.2	+4.6	+3.8	+8.3	+8.0	+6.1	+9.2
2. Foreign Exchange		x	x	x	x	x	x	x	x	x
B. Gold		+33.0	+38.5	+35.9	+36.6	+36.3	+36.6	+36.6	+36.4	+36.3

[1]at $ = SDR, and gold at 35 per ounce.

Table A1 (continued)
Gross and Net International Monetary Reserves: 1949–1983
(SDR and $ billions)

MEASURED IN DOLLARS[2] (End of Year)	1949	1969	1972	1978	1979	1980	1981	1982	1983
I ASSETS	45.3	79.0	187.5	556.3	844.6	971.8	770.2	797.9	748.4
A. Credit Reserves	12.6	40.2	120.9	319.7	313.0	355.5	354.9	322.7	352.7
1. Concerted	1.7	6.7	16.3	29.9	31.9	36.5	43.9	47.7	56.0
a) SDR Holdings	x	x	9.4	10.6	16.4	15.1	19.1	19.6	15.1
b) Res. Pos. in IMF	1.7	6.7	6.9	19.3	15.5	21.5	24.8	28.1	41.0
2. Foreign Exchange	10.9	33.5	104.6	289.8	281.1	318.9	310.9	275.0	296.6
3. Gold	32.7	38.7	66.6	236.5	531.6	616.4	415.3	475.2	395.7
II LIABILITIES (–)	–11.1	–38.6	–115.9	–315.3	–309.2	–351.9	–351.5	–320.0	–350.4
1. Concerted	–0.2	–5.1	–11.3	–25.5	–28.1	–33.0	–40.5	–44.9	–53.7
a) SDR Allocations	x	x	–10.1	–12.1	–17.6	–22.2	–24.9	–23.6	–22.4
b) to IMF	–0.2	–5.1	–1.2	–13.4	–10.5	–10.8	–15.6	–21.3	–31.3
2. Foreign Exchange	–10.9	–33.5	–104.6	–289.8	–281.1	–318.9	–310.9	–275.0	–296.6
III NET RESERVES	+34.2	+40.4	+71.6	+240.9	+535.4	+619.9	+418.8	+477.9	+398.0
A. Credit Reserves	+1.5	+1.7	+5.0	+4.4	+3.8	+3.5	+3.4	+2.7	+2.3
1. Concerted	+1.5	+1.7	+5.0	+4.4	+3.8	+3.5	+3.4	+2.7	+2.3
a) SDRs	x	x	–0.7	–1.6	–1.1	–7.1	–5.8	–4.1	–7.3
b) on IMF		+1.7	+5.7	+5.9	+5.0	+10.6	+9.3	+6.8	+9.6
2. Foreign Exchange	x	x	x	x	x	x	x	x	x
B. Gold	+32.7	+38.7	+66.6	+236.5	+531.6	+616.4	+415.3	+475.2	+395.7
Memo: a) U.S. dollars per SDR	1.000	1.000	1.0857	1.3028	1.3173	1.2754	1.1640	1.1031	1.0470
b) U.S. dollars per ounce of gold	34.71	35.20	64.90	226.00	512.00	589.50	397.50	456.90	381.50
c) U.S. dollars per ounce of gold divided by 35	0.9917	1.0057	1.8543	6.4571	14.6283	16.8429	11.3571	13.543	10.900

[2]at market exchange rates and gold prices.

Sources: a) of SDR estimates: latest *International Financial Statistics* (March 1984); and *Yearbook* (1979 and 1983), corrected as shown in separate Note. b) of dollar estimates: for Credit Reserves: SDR estimates x U.S. dollars per SDR (memo a); for Gold: SDR estimates x U.S. dollars per ounce, divided by 35 (memo c).

Table A2
Composition and Regional Distribution of International Monetary Reserves
($ billions, at market prices and exchange rates)

	End of 1969							End of 1983						
	Industrial Countries			Nonindustrial Countries			All Countries	All Countries	Industrial Countries			Nonindustrial Countries		
	United States	Others	Total	Total	Oil Exptg.	Other			United States	Other	Total	Total	Oil Exptg.	Other
I ASSETS	17.0	42.0	59.0	20.0	4.1	15.8	79.0	748.4	123.1	391.5	514.6	233.8	94.1	139.7
A. Other than Gold	5.1	20.9	26.0	14.3	2.8	11.4	40.2	352.7	22.6	156.7	179.3	173.4	78.0	95.4
1. Concerted	2.3	3.6	5.9	0.8	0.2	0.6	6.7	56.0	16.3	22.5	38.8	17.3	13.4	3.8
a) SDR Holdings	x	x	x	x	x	x	x	15.1	5.0	7.0	12.1	3.0	1.6	1.4
b) Reserve Position in IMF	2.3	3.6	5.9	0.8	0.2	0.6	6.7	41.0	11.3	15.4	26.8	14.2	11.8	2.4
2. Foreign Exchange	2.8	17.3	20.1	13.4	2.7	10.8	33.5	296.6	6.3	134.2	140.5	156.2	64.5	91.6
B. Gold	11.9	21.1	33.0	5.7	1.3	4.4	38.7	395.7	100.5	234.8	335.3	60.4	16.1	44.3
II LIABILITIES (−)	−18.9	−18.4	−37.3	−1.3	−0.1	−1.1	−38.6	−350.4	−202.1	−109.6	−311.8	−38.6	−2.0	−36.6
1. Concerted	−1.0	−2.8	−3.8	−1.3	−0.1	−1.1	−5.1	−53.7	−5.1	−10.0	−15.1	−38.6	−2.0	−36.6
a) SDR Allocations	x	x	x	x	x	x	x	−22.4	−5.1	−10.0	−15.1	−7.3	−1.6	−5.8
b) Debt to IMF	−1.0	−2.8	−3.8	−1.3	−0.1	−1.1	−5.1	−31.3	–	–	–	−31.3	−0.4	−30.8
2. Foreign Exchange	−17.9	−15.6	−33.5	–	–	–	−33.5	−296.6	−197.0	−99.6	−296.6	–	–	–
III NET RESERVES: I + II	−1.8	+23.5	+21.7	+18.7	+4.0	+14.7	+40.4	+398.0	−79.0	+281.8	+202.8	+195.2	+92.0	+103.1
A. Other than Gold	−13.8	+2.4	−11.3	+13.0	+2.7	+10.3	+1.7	+2.3	−179.5	+47.0	+132.5	+134.8	+76.0	+58.8
1. Concerted	+1.3	+0.8	+2.1	−0.4	+0.1	−0.5	+1.7	+2.3	+11.2	+12.5	+23.7	−21.3	+11.4	−32.8
a) SDR Accounts	x	x	x	x	x	x	x	−7.3	−0.1	−3.0	−3.0	−4.3	–	−4.4
b) IMF Accounts	+1.3	+0.8	+2.1	−0.4	+0.1	−0.5	+1.7	+9.6	+11.3	+15.4	+26.8	−17.1	+11.4	−28.4
2. Foreign Exchange	−15.1	+1.6	−13.4	+13.4	+2.7	+10.8	x	x	−190.7	+34.5	−156.2	$156.2	+64.5	+91.6
B. Gold	+11.9	+21.1	+33.0	+5.7	+1.3	+4.4	+38.7	+395.7	+100.5	+234.8	+335.3	+60.4	+16.1	+44.3

Source: *International Financial Statistics,* Yearbook, 1983 for end of 1969; and March 1984 for end of 1983, with corrections explained in separate *Note.*

Table A3
U.S. Balance of Payments and Capital Flows: 1950–1983
($ billions)

	Average Yearly Flows					Year	Year
	1950–59	1960–69	1970–82	1970–78	1979–82	1982	1983
A. Net Earnings on Past Investments	2.1	4.9	18.3	13.0	30.4	27.3	23.6
B. Other Current Transactions	2.2	2.1	−14.2	−8.5	−27.0	−32.5	−50.8
1. Merchandise	2.9	4.1	−14.9	−8.5	−29.4	−36.4	−60.6
2. Military[1]	0.1	−0.9	0.3	0.8	0.7	0.8	0.7
3. Other services	−0.2	−0.1	2.4	1.0	5.4	5.7	4.3
4. Pensions and Remittances	−0.6	−1.0	−1.9	−1.8	−2.4	−2.6	−2.6
I. Income Accounts[2] = *Unadjusted Capital Accounts*	4.3	7.0	4.2	4.5	3.4	−5.2	−34.6
A. Foreign Aid	6.2	5.3	8.3	7.5	10.1	11.8	11.1
1. Economic and Military Grants	4.4	3.6	5.0	4.9	5.2	6.1	6.2
2. Net Assets	1.8	1.6	3.3	2.7	4.9	5.7	4.9
B. Other Capital	−1.9	1.7	−4.1	−3.0	−6.7	−16.9	−45.7
II. Adjustments to Capital Accounts	−4.2	−4.9	−6.1	−3.9	−11.1	−23.8	n.a.
A. Deduct Grants	−4.4	−3.6	−5.0	−4.9	−5.2	−6.1	−6.2
B. Valuation and Coverage	0.2	−1.3	−1.1	1.0	−5.9	−17.7	n.a.
1. Foreign Aid	−1.3	−0.2	–	–	–	−0.2	n.a.
2. Other Capital	1.5	−1.1	−1.1	1.0	−5.9	−17.5	n.a.
III. Capital Accounts, Adjusted (except 1983) = I+II	0.1	2.1	−1.9	0.6	−7.7	−28.9	−45.7
A. Foreign Aid	0.5	1.5	3.3	2.6	4.9	5.5	4.9
B. Other Capital[3]	−0.4	0.6	−5.3	−2.0	−12.6	−34.4	−45.7
1. Statistical Discrepancy	−0.3	0.6	−10.1	−1.2	−30.1	−41.4	−7.1
2. Other	−0.1	–	4.8	−0.8	17.6	−7.0	−38.6
[1]Including transfers of goods and services under military grants programs	2.4	1.8	1.6	2.0	0.6	0.6	0.7
[2]*Income Accounts* (line I) =	4.3	7.0	4.2	4.5	3.4	−5.2	−34.6
a) Reported Current Account	−0.1	3.3	−0.8	−0.4	−1.8	−11.2	−40.8
b) Plus Goods & Services financed by economic & military grants	4.4	3.6	5.0	4.9	5.2	6.1	6.2
[3]Including "contingent" liability for cumulative SDR allocations converted into $	x	x	−0.4	−0.3	−0.6	+0.3	−0.8

Sources: *Survey of Current Business*, June and August 1983; plus for early years rough estimates derived from *Historical Statistics of the United States* and *Annual Report of the Council of Economic Advisers*.

Table A4
U.S. International Investment Position: 1949–1982
($ billions)

	End of Year					Total Flows					Average Yearly Flows					
	1949	1959	1969	1978	1982	1950-59	1960-69	1970-82	1970-78	1979-82	1950-59	1960-69	1970-82	1970-78	1979-82	Year 1982
I. Excluding Foreign Aid																
A. Liabilities (−)[1]	−20	−48	−103	−387	−804	−28	−55	−701	−284	−417	−3	−6	−54	−32	−104	−146
1. Money Market[1]	−7	−20	−49	−263	−450	−13	−30	−401	−213	−187	−1	−3	−31	−24	−47	−80
a) to Official Institutions[1]	−3	−11	−19	−176	−195	−8	−9	−175	−157	−19	−1	−1	−14	−17	−5	−8
b) Other: Treasury Securities and Bank Liabilities	−4	−9	−30	−87	−255	−5	−21	−255	−57	−169	−1	−2	−17	−6	−42	−72
2. Other[2]	−13	−28	−54	−124	−354	−15	−26	−300	−71	−230	−2	−3	−23	−8	−57	−67
B. Assets[3]	43	66	128	394	760	23	+61	+633	+266	+367	+2	+6	+49	+30	+92	+112
1. Money Market[3]	27	25	30	150	436	−2	+5	+406	+120	+287	—	+1	+31	+13	+72	+113
a) Official Reserves[3]	26	22	17	19	34	−5	−5	+17	+2	+15	−1	−1	+1	—	+4	+4
b) Bank Claims	1	4	13	131	402	−2	+9	+389	+118	+272	—	+1	+30	+13	+68	+109
2. Other	16	41	98	244	324	+26	+56	+226	+147	+80	+3	+6	+17	+16	+20	−1
C. Net Assets (=A+B)[1,2,3]	+23	+19	+25	+7	−44	−4	+6	−68	−18	−50	—	+1	−5	−2	−13	−34
1. Money Market[1,3]	+21	+6	−19	−113	−14	−15	−25	+6	−94	+99	−2	−3	—	−10	+25	+34
a) Official Reserves[1,3]	+23	+11	−2	−157	−161	−12	−13	−159	−155	−3	−1	−1	−12	−17	−1	−4
b) Other	−2	−5	−17	+44	+147	−3	−12	+164	+61	+103	—	−1	+13	+7	+26	+38
2. Other[2]	+2	+13	+44	+120	−30	+11	+31	−74	+76	−150	+1	+3	−6	+8	−38	−68
II. Foreign Aid Assets[4]	11	16	31	54	74	+5	+15	+43	+24	+20	+1	+2	+3	+3	+5	+6
III. Total Net Assets (=IC+II)[1,2,3]	+34	+35	+56	+61	+30	+1	+21	−25	+6	−31	—	+2	−2	+1	−8	−29
1. Reported in Survey Tables	+39	+43	+58	+76	+169	+4	+15	+110	+18	+92	—	+2	+9	+2	+23	+12
2. Minus	−5	−8	−3	−15	−138	−3	+6	−135	+12	−123	—	+1	−10	−1	−31	−41
a) Statistical Discrepancy	−5	−8	−3	−12	−133	−3	+6	−130	−9	−121	—	+1	−10	−1	−30	−41
b) "Contingent" SDR liabilities, converted into $	x	x	x	−3	−5	x	x	−5	−3	−2	x	x	—	—	−1	—

[1]To facilitate reconciliation with Table A3 (U.S. Balance of Payments and Capital Flows: 1950–1982), "contingent" SDR liabilities are added to money market liabilities to official institutions.

[2]"Other" liabilities include the "statistical discrepancy" which the *Survey of Current Business* repeatedly considers "as probably in large part accounted for by unrecorded capital inflows," but nevertheless excludes *totally* from the capital accounts reported in its tables, thus implying that they belong entirely to the current account balance. Readers of my table may wish to assign a portion of these liabilities to the current, rather than to the other capital, account.

The Morgan Guaranty *World Financial Markets* (February 1984, p. 3) suggests that this be done for *one-fifth* of the huge asymmetry in published current account transactions for the world as a whole. Using for this purpose the latest *Balance of Payments Statistics* of the IMF, (volume 34 *Yearbook* Part 2, p. xii), the $38 billion and $68 billion net capital inflows shown in the last two columns of line IC2 would be moderately reduced to about $30 billion and $50 billion respectively.

My cumulative estimate of $5 billion at the end of 1949 is obviously a *rough guesstimate,* but is only an insignificant fraction of the $138 billion estimate at the end of 1982, $121 billion of which comes from the *Survey's* estimate for the years 1979–1982.

[3]The gross and net asset estimates for the years 1978 and 1982 would be raised by $109 billion if gold holdings were included at market prices rather than at $42.20 per ounce, but such an estimate would be equally unrealistic, since substantial sales would depress considerably the current market price.

[4]Foreign aid assets, mostly on LDCs, are of little relevance to the dollar's strength on the exchange market, and are generally more akin to "grants" than to real "assets."

Sources: see Table A3.

Discussion

Robert Solomon*

I am honored and very pleased to be participating in this commemoration of the important meeting that occurred here 40 years ago. That meeting immortalized the name of this small place because of its lasting effects.

This is a time for memories, even nostalgia, as we review what has happened over the four decades. I suspect that most of us who are here today were unaware of the Bretton Woods conference in July 1944. Either we were too young or, like me, we were involved in World War II, perhaps even preoccupied with staying alive. But our well-being has been affected by what happened here.

Those who met here in 1944 were determined to make the postwar world a better place economically than the world my generation grew up in. Despite all the monetary crises, misalignments, liquidity explosions, bouts of inflation, stagflation, and recession, and despite the many problems still crying for solution, especially in the developing world, there is no doubt that the period since the end of World War II has witnessed an enormous increase in prosperity and much more economic cooperation than ever before. It has also witnessed an increase in international economic and financial interdependence far beyond the dreams of the founding fathers of the Bretton Woods institutions. The lessons of the 1930s may not have been learned perfectly, but they were learned. For that, we pay homage to those who met here 40 years ago.

What did they accomplish? They established two institutions that are an integral part of the international landscape and that have made numerous contributions to the economic welfare of the world. And they acted on the idea that international economic and monetary arrangements are not God-given and immutable. Rather they are subject to improvement and reform.

Did they bequeath us an international monetary system? That is a question about which people may differ, depending in part on how they define the word system. I shall avoid semantic hair-splitting. But I do want to make the point, with all due respect to those who labored here 40 years ago, that there were basic flaws in the monetary arrangements that emerged from the Bretton Woods conference. The breakdown of those arrangements in the 1970s was not just the result of human perversity or failure to live up to the rules that were established here.

The flaws pertained to both the balance of payments adjustment process and the provisions for international liquidity.

Regarding balance of payments adjustment, there were really no rules or guidance to Fund members. Countries could alter their exchange rates only in the event of "fundamental disequilibrium." But what were the criteria for

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actions to restore equilibrium? Keynes had proposed a set of rules, but they were not accepted by the American side. The implicit criterion was that countries in deficit, other than the United States, had to restrict aggregate demand when their reserves ran low. Often this involved a crisis, as in the case of the United Kingdom and France in the 1950s, Italy in 1963, Britain again and again in the mid 1960s, France in 1968–69, and finally, the United States in 1971. It is commonplace to observe that these arrangements were asymmetrical. Countries in surplus were under little pressure to adjust. The scarce currency clause was designed to prevent this asymmetry, but it did not work. As a result, misalignments developed and persisted under the old system too. Remember that the Smithsonian agreement produced a "realignment" of exchange rates.

Regarding international liquidity, the Bretton Woods Agreement made no provision for the regular increase in reserves required by a growing world economy. Whether the designers of the Agreement anticipated that the dollar would play a major role as a *source* of reserve growth, I do not know. But that is what happened. It was Robert Triffin's brilliant insight that the system was unstable—expressed in the well-known Triffin dilemma. And as Robert also pointed out, the supply of new reserves was haphazard, depending on the vagaries of gold production (or that part of it that found its way into official reserves) and changes in the U.S. balance of payments. The agreement to establish Special Drawing Rights was designed to correct this flaw in the Bretton Woods arrangements. To be more precise, SDRs were a necessary, but not a sufficient, condition for dealing with the unstable supply of world reserves. But the SDR agreement came too late and nothing was done to correct the other flaw—that in the adjustment process.

It is not a mark of disrespect to the founding fathers to point out that the Bretton Woods Agreement was flawed. We who followed had the chance to improve it. It was we who failed, though sporadic attempts at reform were made over the years.

I have already mentioned the SDR, a significant reform accomplished in the 1960s, thanks in no small part to the efforts of former Secretary of the Treasury Henry Fowler, who is here with us today.

In the late 1960s, there was much discussion in official circles, as well as in the academic community, of introducing greater flexibility into the exchange rate regime. The IMF carried out a study and published a report that was noncommittal. American officials, at least those in the Treasury, were nervous about discussing the subject in public. And a number of Europeans were opposed on the grounds that a reform that facilitated upward movements of their currencies would take the United States off the hook of a weak balance of payments. The basic problem was that what was needed was not only more flexible exchange rates but a correction of the misalignment that existed. The dollar was overvalued. Thus the exchange rate reform got nowhere.

In the Committee of Twenty, in 1972–74, another opportunity arose to reform the system, adapting it to the conditions of the last quarter of the century and correcting the shortcomings of the original Bretton Woods agreement. It is perhaps ironical, but explicable, that in 1972 the United States put

forward a detailed proposal for strengthening the adjustment process, a proposal strikingly similar to the one formulated by Keynes in the early 1940s. The principal author of the American proposal was Paul Volcker. The principal opponents were some of our friends in Europe, who, like the Americans 30 years earlier, thought that their countries would be eternally in balance of payments surplus.

Whether the Committee of Twenty could have succeeded in establishing a workable and improved system, we shall never know. Its efforts were overtaken by events—namely, the quadrupling of the price of oil in late 1973. That put an end to longer-term planning and concentrated the minds of policymakers onto current problems. The oil-price explosion also put an end to the notion that floating exchange rates were a temporary aberration, which in turn led to the revision of the IMF Articles of Agreement, especially Article IV dealing with exchange rates.

The next effort at reform occurred in Europe, with the establishment of the European Monetary System (EMS). As Robert Triffin has stressed, that was a reform that succeeded. The present occasion demands that a few words be said about Robert himself.

Robert Triffin was always in the forefront, as he is today, of those who regard institutions as perfectable. Robert is a natural-born reformer. While at the Federal Reserve Board, he helped to establish central banks in Latin America. He was a, if not *the*, father of the European Payments Union, which had so much to do with freeing up trade in Europe in the early postwar years. He put forward proposals for creating a new reserve asset. He produced several books that will always be part of the essential body of work on international monetary affairs. And, at Yale, he helped to nurture and turn out a generation of students of international monetary economics who are now prominent in the profession.

As you have just heard, Robert is not happy with the operation of present international monetary arrangements. Nor am I, though perhaps for different reasons. What I find missing in Robert's presentation is a discussion of the *process* by which the increase in international reserves has caused world inflation under existing arrangements. He speaks of the ability of the United States to settle its deficits in dollars. Yet whether or not other countries acquire dollars depends on whether or not their central banks choose to intervene.

Robert also states that the present system of world reserve creation leads to "the financing of the richer and more heavily capitalized countries by poorer, capital-short countries." This conclusion is based on net reserve positions at the end of 1982, which show the United States as a net reserve debtor to the extent of $149 billion, while developing countries were net reserve creditors to the extent of $133 billion, (of which oil exporters account for almost 60 percent). It does not follow that capital has not been flowing from the richer to the poorer countries. The debt crisis of the past two years tells us that.

As is evident elsewhere in Robert's paper, the United States has been a heavy lender to developing countries. Its nonreserve claims far exceed its

reserve liabilities. It has provided capital to poorer countries. But the United States is also a bank to the rest of the world, as Emile Despres, Charles Kindleberger, and Walter Salant were at pains to point out to us back in the 1960s. A bank will inevitably have liabilities that are more liquid than its assets. Robert recognizes this, of course, but he does not accept the reserve-currency role of the dollar with satisfaction. I have never been a dollar chauvinist. But until someone has the wit and will to replace with a workable scheme the arrangements under which the United States now assumes the role of world financial intermediary, we have to expect Robert Triffin's carefully constructed tables to continue to show what they do.

In the second part of his paper, devoted to the EMS, Robert focuses on the private market development of the ECU, telling us that crucial reforms are determined mainly by the private sector. To support this thesis, he reminds us that the members of the Group of Ten, when discussing reform of the system in the 1960s, "unanimously regarded the stability of exchange rates and of the price of gold—at $35 per ounce—as the two unshakable pillars of any international monetary system, present or future! " I hope that Robert has his tongue in his cheek when he reminds us of this. He appears to take this declaration too seriously. As Robert undoubtedly knows, it was American officials who insisted on these strictures, and for understandable reasons. A banker cannot let doubt be cast on the future value of his or her liabilities. We used to talk in the 1960s—thanks to the late Fritz Machlup—of three elements of the system: adjustment, liquidity, and confidence. It was to preserve confidence that the Americans insisted on the two unshakable pillars.

Robert presents us with an interesting account of the growing use of the ECU and advises the EMS officials to stop monetizing increases in the price of gold. I find this treatment of the ECU to be noncontroversial.

Robert also brings out the "success story" of the EMS in maintaining stability of real exchange rates among its members while exchange rates with outside currencies, notably the yen and the dollar, have fluctuated wildly. It would be of interest to know what costs, if any, have been associated with this benefit of exchange rate stability. Have there been costs to some members of the EMS in the form of lower employment and real income?

Depending on the answer to this question, we have every reason to join Robert Triffin in blessing the EMS and wishing it well. It seems to be a reform that is working.

General Discussion

Robert Triffin stated that observers, on the whole, have been surprised at the success of anti-inflationary policies within the EMS. But he has come across little support for the view that employment and income have been lower in the EMS countries than in the absence of the system.

Lord Eric Roll posed two questions to Triffin. First, why has Great Britain not yet entered the EMS? Second, has the EMS induced greater policy convergence among member countries than would have been attained without it?

On the first question, Triffin remarked that Great Britain did not enter the EMS initially because such an action was expected to make it more difficult for the pound sterling to depreciate. In fact, the pound sterling appreciated relative to EMS currencies over recent years. He conjectured that British industry might have been happier with EMS membership; yet opposition to EMS membership still exists in Britain.

On the second question, Triffin expressed no doubt that the existence of the EMS has augmented policy convergence among member countries. He added that opportunities for regional coordination among policymakers exist even where wider international economic cooperation is not feasible. This is not to suggest that regional and international coordination are substitutes; rather they are complements. Cooperation among national governments should be pushed as far as is humanly possible.