
TOWARDS A RENOVATED WORLD MONETARY SYSTEM

Motoo Kaji
PROFESSOR
Tokyo University

Richard N. Cooper
PROVOST
Yale University

Claudio Segré
BANKER
Paris

The Trilateral Commission
A Private American-European-Japanese
Initiative on Matters of Common Concern

This Report has been prepared for the Trilateral Commission and is published under its auspices. It was discussed at the Trilateral Executive Committee meeting, held in Tokyo on October 22-23, 1973, and the Executive Committee in its communique “agreed that the report of the task force on monetary problems is an important contribution and urged members of the Commission and the broader public to consider its proposals.” The authors, who are experts from Western Europe, Japan, and North America, have been free to present their own views. The Commission will utilize the Report in making any proposals or recommendations of its own. It is making the Report available for wider distribution as a contribution to informed discussion and handling of the issues treated.

The Trilateral Commission was formed in 1973 by private citizens of Western Europe, Japan, and North America to foster closer cooperation among these three regions on common problems. It seeks to improve public understanding of such problems. to support proposals for handling them jointly, and to nurture habits and practices of working together among these regions.

THE TRILATERAL COMMISSION

c/o European Community
Institute for
University Studies
Rue de Trèves 47
1040 Brussels, Belgium

345 East 46th Street
New York, N. Y. 10017

c/o Japan Center for
International Exchange
8-4-3, Akasaka
Minato-ku
Tokyo, Japan

TOWARDS A RENOVATED WORLD MONETARY SYSTEM

**A Report of the
Trilateral Monetary Task Force**

to the

**Executive Committee of
The Trilateral Commission**

**TOKYO
OCTOBER 22-23, 1973**

Rapporteurs: **MOTOO KAJI**
Professor
Tokyo University

RICHARD N. COOPER
Provost
Yale University

CLAUDIO SEGRÉ
Banker
Paris

The Rapporteurs

MOTOO KAJI was born on August 13, 1925 and graduated from the University of Tokyo in 1950. In 1965, he was appointed lecturer at Tokyo University, and rose to Associate Professor in 1957 and Professor in 1968. He has studied in the United States and recently completed a year of research at Yale University. He is the author of *The American Economy* (in Japanese) and of other works on American and world economic problems, including "A Japanese View," in *Foreign Policy*, Summer, 1973. He is currently Professor of American Studies at the University of Tokyo and specializes in economic matters.

RICHARD N. COOPER was born on June 14, 1934. After receiving his B.A. from Oberlin in 1956, he obtained an M.Sc. in Economics at the London School of Economics. In 1962, he obtained a Ph.D. in Economics at Harvard University. Mr. Cooper served as Senior Staff Economist on the Council of Economic Advisers from 1961 to 1963, and as Deputy Assistant Secretary of State for International Monetary Affairs from 1965 to 1966. He is the author of *The Economics of Interdependence* (1968) and coauthor of *Britain's Economic Prospects* (1968), as well as of numerous articles on economic matters. He is currently at Yale serving as Provost of the University and as Frank Altschul Professor of International Economics.

CLAUDIO SEGRÉ was born in Rome on February 5, 1932. He was awarded the degree of Doctor of Laws and degree in Economic Sciences at the Faculty of Law, University of Rome, and subsequently obtained a Ph.D. at Yale University. In 1959 he joined the General Administration of Economic and Financial Affairs of the Commission of the European Economic Community, serving first as a member of the Monetary Policy Division and later as Chief of the Capital Movements Division (1961) and as Director of Studies and Coordination (1965). From 1965 to 1967 he was chairman of a group of experts established by the EEC Commission to study the development of a European capital market, an effort which resulted in the 'Segré Report'. From 1967 until recently he was Associate Director of Lazard Freres & Cie. and President-Director General of Lazard S.A., Paris. He is currently with the Compagnie Européenne de Placements. Dr. Segre has written extensively on monetary and financial matters.

The Trilateral Process

The report which follows is the joint responsibility of the three rapporteurs of the Trilateral Task Force on Monetary Problems, with Mr. Richard N. Cooper serving as the principal drafter.

Although only the three rapporteurs are responsible for the analysis and recommendations, they were aided in their task by joint or individual consultations held during 1973 in New York City, Washington, Tokyo, Anchorage, Sicily and Paris, which at various stages of the report included a number of government officials as well as the following:

Raymond Barre, *Professor and former Commissioner of the EEC, Paris*

C. Fred Bergsten, *Senior Fellow, the Brookings Institution*

Zbigniew Brzezinski, *Director, the Trilateral Commission*

Sir Alec Cairncross, *Master, St. Peter's College, Oxford University*

Herbert Giersch, *Director, Weltwirtschaftliches Institut, Kiel University*

David L. Grove, *Vice President and Chief Economist, IBM*

Tadashi Iino, *Counselor, Mitsui Bank; former Executive Vice President, Mitsui Bank*

Yves-André Istel, *Kuhn Loeb & Company*

Yusuke Kashiwagi, *Vice President, Bank of Tokyo*

A. Lamfalussy, *Chairman, Steering Committee, Banque de Bruxelles*

Haruo Maekawa, *Deputy President, Export/Import Bank of Japan*

Saburo Okita, *President, Overseas Economic Cooperation Fund, Tokyo*

Giuseppe Petrilli, *Professor and President of IRI*

Grant Reuber, *Dean, Social Sciences, University of West Ontario*

Takuji Shimano, *Professor of Economics*

M. E. Streit, *Professor, University of Mannheim*

Pierro Uri, *Professor, the Atlantic Institute, Paris*

Takeshi Watanabe, *Japanese Chairman, the Trilateral Commission*

SCHEDULE OF MEETINGS AND CONSULTATIONS:

1. Trilateral rapporteurs' meeting (with Brzezinski), Washington, June 23-24.
2. Consultations between Mr. Cooper and Messrs. Kaji and Watanabe concerning the preliminary drafts, Tokyo, July 23-24.
3. Meeting of Messrs. Cooper, Kaji, Segré, Watanabe, and Brzezinski, Anchorage, August 11-12.
4. Meeting of the North American task force concerning the preliminary draft, August 22.
5. Meeting of the Japanese task force concerning the preliminary draft, September 3.
6. Consultations between Mr. Segré and European monetary experts concerning the preliminary draft, Sicily, September 16.
7. Final trilateral drafting session of the rapporteurs, additional consultants and Brzezinski, Paris, September 29-30.

Table of Contents

Summary of the Report of the Monetary Task Force:.....	7
Chapter I. Introduction: Definition of the Problem and the Present State of Discussions.....	9
Chapter II. Differences in National Policies And Perspectives.....	13
Chapter III. Basic Elements of a Renovated System.....	17
1. Balance Of Payments Adjustment.....	17
2. Reserve Assets And Convertibility	20
3. Outstanding Balances.....	23
4. Economic Interdependence	25
5. The Institutional Setting.....	27
Chapter IV. Risks Inherent in the Present Situation.....	28
Chapter V. Interim Priorities and Transitional Measures.....	32
1. Exchange Market Intervention.....	32
2. Consolidation Of Foreign Exchange Balances.....	33
3. Short-term Lending Facilities.....	34
4. Surveillance Of The Eurocurrency Market.....	35
5. Gold Policy	36
Members of the Trilateral Commission	39

SUMMARY OF THE REPORT OF THE MONETARY TASK FORCE:

Towards a Renovated World Monetary System

Monetary anarchy must not be allowed to undermine the confidence in prosperity built up over two decades, nor to produce a new period of restrictions and mutual hostility from entrenched national positions.

Accordingly, it is the view of the rapporteurs that governments should proceed with dispatch to renovate the international monetary system.

The longer range reforms should include:

- i. Improvement of the balance of payments adjustment process, with provision for smaller and prompter changes in exchange rates;
- ii. Confirmation of the central role as primary reserves of an international fiduciary issue, renamed *bancor*, to satisfy world liquidity needs and gradually to supplant other forms of reserve assets;
- iii. Creation of a new facility, to be lodged in the IMF, for emergency short-term lending to counter speculation and other disruptive capital movements;
- iv. Consolidation of foreign exchange reserves, initially on an optional basis, into a new account at the IMF;
- v. Establishment of new and effective consultative machinery, within the IMF, to oversee the functioning of the renovated international monetary system and to encourage the coordination and consistency of domestic economic policies.

The rapporteurs also believe that governments should take a number of

interim steps to help restore order and stability“ to the international monetary system. They should:

- i. Commit themselves to coordinated intervention in exchange markets if necessary to prevent erratic movements in exchange rates;
- ii. Enlarge and multilateralize short-term lending facilities to offset large speculative movements of funds;
- iii. Consolidate, on a basis that can later be taken over by the International Monetary Fund, the excessive official holdings of dollars and other foreign exchange;
- iv. Indicate their willingness both to support the Eurodollar market and to subject it to close surveillance;
- v. Sell gold, on a cooperative and coordinated basis, into private markets, with gains to be transferred to international financial institutions for development assistance.

I.

INTRODUCTION: DEFINITION OF THE PROBLEM AND THE PRESENT STATE OF DISCUSSIONS

Two problems reside at the core of the world economy of modern, mixed-economy industrial nations. The first problem is how to achieve full employment without drifting into rapid inflation, which arises from attempts to pursue conflicting and contradictory objectives without adequate instruments of policy. Monetary management gave governments a great weapon to deal with the periodic depressions that plagued pre-World War II economies; but this same management of money set economies adrift in terms of the real value of their monetary units. Attempts to maintain full employment may, under the ever present pressure for greater real wages, lead to severe inflation.

The second problem is how to combine managed national economies, with their national pursuit of national objectives, into an open, harmonious, and mutually beneficial world economy. Governmental attempts to influence domestic economic events may be frustrated by the movement of funds and firms across national frontiers, and they will be tempted to take defensive action, possibly damaging to other countries.

The first problem is one that all industrial countries face in common, but the solution must mainly come from within; the second is a joint problem that all industrial countries must face together in search of cooperative agreement.

The International Monetary System—the formal rules, the informal conventions, and the institutional arrangements for dealing with financial relations among nations - represents an important, perhaps the most important, component of a harmonious international economic system.

The International Monetary System worked remarkably well until the late 1960's. The growth of production and international trade has been unprecedented. The Bretton 'Woods Agreement of 1944 laid down the basic rules and established the International Monetary Fund (IMF) to oversee their application. The U.S. dollar emerged World War II as an international currency that provided liquidity, elasticity, and financial stability to the international monetary system. But confidence in the dollar – and in the system itself – depended *inter alia* on a well managed

American economy, and that precondition ceased to be met in the late 1960's. Moreover, the growing use of a national currency as an international one ultimately contained the seeds of its own destruction, for sooner or later its convertibility into gold would inevitably have become impaired. It was partly a matter of luck that dollar outflows served world liquidity needs so well for so many years. In addition, financial assets achieved an international mobility to a degree that was totally unanticipated at Bretton Woods, a mobility with which indeed the resulting Agreement was not suited to cope.

The task before us is to renovate the monetary system so that it can do as well in the next two decades as it did in the two decades following the second World War, recognizing that the underlying conditions at present are very different from what they were in the 1940's.

This post-war monetary system formally broke down in August when 1971, when the United States declared that the U.S. dollar was no longer convertible into gold or indeed into any other reserve asset, although the system had shown severe strain even before then. The Smithsonian Agreement of December 1971 brought some relief, but the relief could only be temporary because that agreement represented a stopgap rather than a basic reform of the monetary system and because several major participants, notably Britain and the United States, did not fully accept the exchange rates that were then agreed. Britain broke away from the Smithsonian pattern of exchange rates in June 1972 by floating its currency, and the United States broke with the pattern by devaluing the dollar in February 1973. Massive movements of funds across foreign exchanges and uncertainty about the future of the monetary system led to a general pattern of floating exchange rates in March 1973, followed by a surprising and fundamentally unwarranted depreciation of the dollar, 'combined with erratic movements of the dollar rate and widespread uncertainty about currency values.

In September 1972 the Committee of Twenty finance ministers was established to provide a negotiated basis for improvements in the international monetary system. Their deliberations have proceeded with care, and their results will necessarily be long in coming, for disagreement remains deep on several issues central to a coherent system. They agreed on an outline for further work at Nairobi in September 1973.

A renovated international monetary system cannot offer a panacea for all economic ills. In particular, its contribution to solving the problem of world inflation, which is fundamentally domestic in origin, is

positive but not decisive. The monetary system can influence the extent to which inflationary or contractionary impulses are transmitted from one nation to another; and it can also determine the degree of success in achieving a mutually beneficial division of labor among nations, raising living standards for all.

We do not at present have a coherent international monetary "system;" and we court the risk of losing the substantial gains of the past three decades through a progressive deliberalization of international transactions. There is an urgent need to restore some systematic, mutually agreed international monetary order. A renovated system must command acceptance by all major participants, and it must contain a certain degree of resilience against major economic disturbances of all kinds, including mistakes in economic policy, which are bound to occur from time to time under the political pressures and counterpressures of democratic regimes and the struggles to achieve or maintain power in non-democratic ones. A renovated system must also address the question of what international currency is to prevail in the world, since one or another is bound to emerge, and what will be the conventions governing capital movements, including the proper role for the eurocurrency markets.

Agreement among the leading industrial countries is a necessary condition for a smoothly functioning international monetary system. Their concerns and interests must be accommodated. But this does not mean that they alone have an interest in a smoothly functioning international monetary system. On the contrary, perhaps the greatest proportionate beneficiaries will be the developing countries, whose dependence on international trade and capital for rising standards of living is even greater than that of the large industrial countries, and who therefore have a substantial stake in successful resolution of the present difficulties. Harmony among the leading industrial countries is of the utmost importance to the economic welfare of the developing nations.

As a practical matter, the Communist countries 'of the world have lain outside the "world" monetary system of the past three decades. For the intermediate future, they will continue to lie outside the system, for the differences in their methods of price determination and their modes of economic exchange from those of mixed economies remain sufficiently great that interaction between the two regions, while growing, will continue to be small relative to economic interactions within the non-Communist portions of the world. Greater exchange with Communist

countries should be sought wherever it is possible and mutually advantageous.

Growing world demand for energy, combined with the high natural concentration of petroleum reserves, especially in the Middle East, means that large earnings will accrue over the next decade to countries with relatively small population. This concentration of mobile wealth in the hands of a relatively few countries, not as yet well integrated into the community of nations, creates a possible source of disturbance to financial markets, to foreign exchange markets, and to the orderly functioning of the international monetary system.

We have not attempted to address the problems of or posed by these three important groups of countries – the poor countries, the Communist countries, and the oil producing countries. The issues involved go far beyond the operation of the international monetary system, and since the monetary aspects cannot be discussed satisfactorily without addressing other basic issues, these problems are best left to further work by other task forces of the Trilateral Commission. We believe that the proposals we make below for improvements in the international monetary system are fully compatible with a satisfactory evolution of relations with these countries, and indeed may contribute constructively to that end. In what follows, however, we address the International Monetary System principally from the viewpoint of the non-Communist industrial countries.

II.

DIFFERENCES IN NATIONAL POLICIES AND PERSPECTIVES

All of our countries wish to see the restoration of orderly economic relationships among themselves. However, at present there exist considerable divergences in national policies and perspectives. These divergences stem partly from the fact that each country puts priority on domestic objectives, a priority that is to some extent unavoidable, and that among domestic objectives relative priorities differ from country to country. They stem partly also differences in economic and political structure, with the relative dependence on foreign trade, the degree of industrialization, and the mode of political decision-making varying markedly from country to country. The divergences have been aggravated in recent years by deterioration in mutual confidence. We do not consider the differences in structure or in priorities sufficiently great to make impossible a restoration of world economic order. But a renovated system cannot be realized without first restoring mutual confidence and, with that, a degree of tolerance for diversity of view and circumstance. Better understanding will reduce the present gaps in perspective.

Differences of view often take technical form, but they are not merely technical. Rather, they reflect differences in conception, in condition, and in conventions, conventions that are often based on historical circumstances no longer applicable. These three kinds of differences are often comingled on the same issue. Fortunately, purely national perspectives are rare. It is a sign of maturity in the modern era that differences of view are at least as wide within nations as between them. We identify some of the differences to illustrate their depth and their fundamentally political nature, insofar as basic conceptions must be considered political. By the same standard, our later recommendations also reflect political judgment.

Fundamental differences of view concern the extent to which the international monetary system should – or can – impose “discipline” on domestic economic policies. Some observers believe that the international system should provide a major bastion against excessive economic expansion. Others believe that it should not. Still others believe that it *cannot* provide such a bastion in modern democracies that have all ex-

perienced and used the benefits of managed money. These divergent views are found within most countries.

A second fundamental difference of view, also found within most countries, but to significantly varying degrees, concerns the freedom that should be accorded to international capital movements. Some observers view international capital movements as a major vehicle for economic progress. Others view them as a major source of economic disturbance and therefore a deterrent to economic progress. Still others view capital movements more neutrally, but fear that capital movements cannot be controlled effectively even when on normative grounds a case can be made that they should be. Yet others entertain a sharp distinction on these various grounds between short- and longterm capital movements.

Resentment has been voiced about the "special privilege" of the United States residing in the international use of the dollar; concern has been especially focussed on United States direct investment abroad financed, not by a surplus of goods and services, but by IOU's on the United States picked up by foreign central banks. The United States, for its part, has emphasized the economic costs of the dollar's role and the special responsibilities it carries in the areas of mutual security, and it has badgered other nations to contribute more. Behind much of this debate, brought openly to the surface by the late President de Gaulle, is anxiety over national status in the community of nations, and the special status that having a reserve currency seems to confer.

Yet another area in which difference of opinion is sharp concerns the degree to which exchange rates should be relied upon as a principal mechanism of adjustment in the international monetary system. While all parties recognize the need for some exchange rate adjustment, some feel that this adjustment should be resisted as much as possible, partly on grounds that exchange rate changes do their work only slowly and imperfectly, partly on grounds that extensive reliance on changes in exchange rates will be disintegrative rather than integrative in their influence on the world economy. Others feel that the evolution of national economies has been such as to require much greater flexibility of exchange rates than was enjoyed until the summer of 1971. They argue that the alternative to exchange rates, in general much heavier reliance on controls of international transactions, is likely to be far more disintegrative in its influence than is greater flexibility of exchange rates.

It is increasingly recognized that the arguments on exchange rates do not apply with equal force to all countries, and that relative fixity of

rates may be highly desirable within certain groups of countries. Moreover, the European Community has embarked on the difficult task of achieving monetary integration by the end of the decade and has chosen the course of attempting to reduce exchange rate fluctuations among member countries. It thus finds itself pulled in two directions at the present time, toward somewhat greater flexibility in its relations with the rest of the world and toward less flexibility within Europe. The internal objective inevitably influences its approaches to the broader system.

There are also divergences of view on seemingly technical issues – whether and when and under what circumstances the dollar can become convertible into other reserve assets; whether surplus countries should carry precisely the same responsibilities for balance of payments adjustment as do countries in deficit; whether it is vital to maintain existing export industries at all cost, despite continuing large payments surplus; and whether gold should continue to play an integral role in the monetary system. Divergence on the last issue seems now to be much diminished as a result of the wildly erratic movements of gold prices on private markets in the summer of 1973, and now that gold is no longer necessary as a surrogate for raising questions about the special status of the dollar.

Irritation has especially been expressed over the seemingly “benign neglect” attitude of the U.S. government toward economic developments abroad and toward the evolution of the monetary system, and its apparent disdain of advance consultation in matters, such as import surcharges and export controls, that vitally affect the interests and welfare of its leading trading partners. Differences have also persisted on the interpretation of unfolding events, and especially of the U.S. balance of payments deficit, undeniably too large for too many years. Declining competitiveness, excessive capital outflows, large burdens of aid and defense, foreign need for dollars and foreign unwillingness to adjust, and many other explanations have been invoked to explain the large deficit, too often in a search for blame and a spirit of recrimination.

We believe that some of these many differences of view will disappear with continuing frank discussion and consultation. But we also believe that some differences will remain, even after the compromises that inevitably must be made in an attempt at reconciliation in achieving common ground for renovating the international monetary system. An important feature of a renovated system is precisely its scope for accom-

modation of nations with widely different circumstances and even with somewhat different basic preferences regarding the objectives of economic policy. It must be resilient both to differences in condition and to errors in policy. The section that follows attempts to lay down the principal features of a renovated system.

III.

BASIC ELEMENTS OF A RENOVATED SYSTEM

Despite divergent perspectives and in some cases fundamental disagreement on detail, there is now wide convergence of view on the areas that require improvement in the international monetary system. In this section, we discuss those areas and offer our view, in general terms, on the appropriate dimensions of renovation:

1. balance of payments adjustment;
2. reserve assets and convertibility;
3. the problem of outstanding balances;
4. growing economic interdependence, calling for greater harmony in national economic policies; and
5. institutional aspects of this renovated monetary system.

1. Balance of Payments Adjustment

Many economic forces, continually changing, affect each nation's balance of international payments. One of the most common influences arises when a country's economy enters a period of excessive or deficient expansion of demand in relation to the country's domestic economic objectives. Excessive expansion of demand will typically worsen the balance of payments, although in the present era of high capital mobility occasions may arise in which the tight money associated with excessive expansion improves the balance of payments, as it did for the United States in 1969. Deficient expansion in domestic demand, on the other hand, will typically improve the balance of payments. Under either circumstance, actions to direct the domestic economy back onto the preferred course will help to correct the balance of payments, and no special action therefore needs to be taken to correct the disequilibrium in the balance of payments.

There are, however, also many other forces – stemming from technological change, from international differences in growth in incomes and output, from discoveries and exhaustion of natural resources, from changes in taste, and from many other factors – that influence the balance of payments and that may create imbalance in payments. An

effective international monetary system must have some method for eliminating payments imbalances as they arise under the pressure of these various influences.

The Bretton Woods System, which was formally in force from the late 1940's until 1971, relied in the main on a combination of short-term financing and exchange rate adjustment. As that system worked in practice, exchange rate adjustment was often too late, too one-sided toward currency depreciation, and when it came, too large. The system relied to a greater extent than had been planned on trade quotas and on inflation or deflation in domestic demand. It took for granted controls on capital movements. By the time a "fundamental disequilibrium" gave rise to a change in an exchange rate, the need for such change was apparent to many observers and that in turn gave rise to large and disruptive flows of speculative funds. The large exchange rate adjustments for their part administered substantial shocks to economies, since calculations of profit and loss had been made with quite different expectations. These deficiencies suggest that future exchange rate changes should be smaller and if necessary more frequent as corrective measures. *We believe that a renovated monetary system should impose substantial pressure for timely exchange rate changes, by countries in surplus as well as by countries in deficit.* Changes in exchange rates, however, will not produce the expected results unless they are accompanied by domestic monetary and fiscal actions appropriate for making the change effective.

The time may come when the need for exchange rate changes diminishes as national economies become ever more closely linked to one another and as this evolution leads to a harmonization of national economic objectives and of national economic policies. But that day is still far off for the world as a whole. In the meantime, changes in exchange rates will be necessary for keeping national economies in line in a liberal world economic setting.

One of the most difficult tasks in balance of payments adjustment is identifying those cases in which domestic action in pursuit of generally agreed domestic economic objectives will alone be sufficient to deal with imbalances in payments, and separating them from those cases in which direct action on the exchange rate is required to correct an imbalance of payments. Broadly speaking, the pre-1971 system erred too heavily in avoiding changes in exchange rates when they were in fact desirable. The renovated monetary system should correct that; there should be a much heavier presumption in favor of altering exchange

rates, recognizing that in so shifting the presumption, some errors of the opposite type will be created.

In sorting out cases in which exchange rates should not be made from those in which they should be, the economic developments of major countries should be kept under continuous review by the revamped International Monetary Fund, along the lines discussed below, so that cumulatively large disequilibria are not permitted to develop. If changes in exchange rates seem to be indicated, refusal by a country to introduce such changes should invoke sanctions by the international community. For a country in balance of payments deficit these sanctions might involve refusal to lend to it for financing its payments deficit. For a country in balance of payments surplus, the sanction might involve financial measures such as nonpayment of interest on reserves above a certain level; and in *extremis* might involve imposition of import surcharges, under international surveillance, against its goods – that is, a de facto partial revaluation of its currency through the trade policies of other countries. If these possible sanctions are effective in their intent, they will of course never have to be used, for they will encourage the appropriate adjustment actions well before the sanctions would be brought into play.

It has been suggested that exchange rates should be allowed to float freely, determined solely by the market forces of supply and demand. Reform along these lines is neither practicable nor desirable. For most countries the exchange rate remains one of the most important single economic variables. As long as governments are held responsible for national economic development, they cannot abdicate all responsibility for movements in the exchange rate. Freely floating exchange rates run the risk that occasional speculative forces may push the exchange rate far from a position that is warranted on fundamental economic grounds. Appropriate government policy calls ultimately for management of the exchange rate, just as appropriate government policy these days calls for management of domestic monetary conditions.

A par value system, if properly managed, can provide adequate exchange rate flexibility. A “par value” system is one in which each country declares a fixed relationship between its currency and the primary reserve asset in any proposed system. Market rates may vary on either side of the par value within a permissible band of flexibility. A system of managed exchange rates without par values could, without undue complication, also provide a satisfactory combination of flexib-

ility. Rules for exchange market intervention would be required to ensure the consistent and harmonious evolution of exchange rates. We have not adopted this approach here, however, so we do not develop in detail what a system of that type might look like.

2. Reserve Assets and Convertibility

During the 1950's and the early 1960's the international monetary system came to rely heavily on the United States dollar as a functioning reserve asset. This dependency had certain advantages, especially in the elastic provision of liquidity, but it also had disadvantages that have now become clear. Reliance on the dollar (or indeed on any national currency) places the reserve currency country in a special position that can be abused and is likely to generate resentment in other countries. Excessive outflows of dollars in the late 1960's and early 1970's led to the suspension of convertibility of the dollar into gold and Special Drawing Rights, which in turn led to the general floating which came into effect in March 1973. A renovated system needs to place the new Special Drawing Rights (SDRs) in a position of primacy among reserve assets. SDRs, properly managed, can provide for adequate and controlled growth in world liquidity. Under the system of exchange rate parities that we envisage, all currencies including the dollar would be convertible to SDRs at a fixed but alterable price. The United States would be expected to finance any payments deficits by drawing on its holdings of Special Drawing Rights.

If ever greater reliance is to be placed upon SDRs, the nature of the SDR must be improved. To that end, *we would (i) abolish 'the holding limits and the reconstitution provision of the present SDR; (ii) raise interest rates closer to interest rates on alternative reserve assets, but with allowance for the special character of the SDR; and (iii) break the formal tie to gold.* We would also give the SDR a distinctive designation, not dependent on acronyms constructed on the basis of national languages, to underline its monetary independence. We can think of no more fitting term than "*bancor*," the designation J. M. Keynes used in his proposal for the creation of a postwar international financial institution, later to become the International Monetary Fund. We would however, retain for some time the requirement that *bancor* be used only for financing balance of payments deficits, thus discouraging its use for the conscious shifting of reserve assets from one form to another.

We envisage that *bancor* would be an abstract unit of account. From

a formal point of view, it would be fully defined at any moment in time by its relationship through par values to all currencies of the world. In day-to-day operation, it would be defined by market exchange rates through some designated currency. We feel that this approach is far simpler than the "bouquet of currencies" approach to the definition of bancor that has sometimes been discussed.

We also envisage that bancor would become a unit of account in many private international transactions, and that financial instruments might be denominated in bancor. Monetary authorities should not impede this development. Eventually bancor might circulate as a genuine international currency and be used as a medium for an intervention in exchange markets, but that development would take place only gradually and is beyond the period with which we are concerned. It would of course require widening the eligibility for holding SDRs, from central banks alone, to include other financial institutions and even individuals.

The stipulation that bancor is to meet all global liquidity needs implies that the *United States and all other countries must finance their balance of payments deficits only by using reserve assets, not through the foreign acquisition of additional dollars or other reserve currencies.* This is the convertibility requirement. Conversion would be obligatory for the United States even when other countries chose to add to their dollar holdings, which they would remain free to do. Thus international control would be assured over global liquidity creation, but individual countries would be left free to choose the particular assets they desire to hold in their reserves, insofar as those assets arose from current balance of payments surpluses. They could not, however, convert at will dollars acquired in one period directly into bancor at a later period.

The need to finance deficits with bancor or other reserve assets, by each country standing ready to convert foreign official acquisitions of its currency into other reserve assets at a known price, implies the need to defend that price from time to time. This could become a constraining factor on domestic economic policy. The key judgment that must be made in the renovated monetary system is when to defend the fixed price between each national currency and bancor and when to alter it. This issue is, in a different form, the same issue as that discussed above in connection with how often to require changes in exchange rates for balance of payments adjustment. There will inevitably be occasional disagreements over just how far a country should be expected to go in and adjusting its domestic economic policies so as to defend a fixed ex-

change rate before a change in that exchange rate becomes generally acceptable. What is needed is a framework in which such disagreements can be discussed and resolved. *That framework should involve both general presumptive guidelines for balance of payments adjustment, requiring for example that substantial reserve movements in either direction should lead to balance of payments adjustment actions, and a procedure for evaluation of alleged special circumstances and for resolution of disagreements.* Individual nations would formally be free to determine their exchange rates, so their nominal sovereignty would be unimpaired. But they would have this freedom only with accountability to the community of nations, and by violating the collective judgment of other nations they would run the risk of incurring the sanctions discussed above.

It has frequently been proposed that a link be established between the creation of international liquidity and the provision of development assistance by allocating a substantial share of newly created SDRs directly or indirectly to developing countries. This proposal represents a major issue in current discussions of reform of the monetary system, and it addresses a major problem of the world community. We accept the importance of the problem, but we do not favor this particular solution to it. Creation of international money involves a new, bold, and still fragile experiment. Until it is fully established, the SDR, revamped or not into bancor, will be under some suspicion. It is necessary to build confidence in such a new asset, resting on the cooperation of many countries, and confidence can come only gradually through experience with its successful creation and use. Establishment of a link to development assistance runs a serious risk of undermining confidence in the new asset before it is fully established. Moreover, it is doubtful that separation between the creation of bancor to serve the needs of international liquidity and its use for development assistance could be successfully sustained. Occasions will surely arise when the claims for control of world liquidity and the always pressing claims of developing countries for the transfer of additional resources will conflict. There is no assurance that the former claims will dominate, as they must if international liquidity is to be successfully controlled. The doubts of skeptics about managed international money will be reinforced under these conditions. Finally the creation of international money does not in itself generate the real resources which are required to be transferred to less developed countries. We believe it is preferable to take direct measures, through national fiscal action, to generate those resources.

Relations between the developed and the less developed countries will be the subject of analysis by another group, and we cannot do justice to this complex topic here. We simply state our strong support for substantially greater transfer of resources to less developed countries than is now taking place. We suggest one mechanism below for helping to accomplish this objective. There are many others as well that do not court the risk of undermining the new international reserve asset before it is fully established.

3. Outstanding Balances

The presence of large outstanding official balances, a legacy of past United States balance of payments deficits, threatens any system of convertibility and may lead to unwarranted and unacceptable changes in exchange rates. These balances represent a heavy psychological burden, which in the spring of 1973 depressed the market for the dollar. A renovated international system requires some mechanism for dealing with this "overhang" of dollar balances. *We favor a system whereby countries that hold dollar balances can convert them into bancor in a new International Monetary Fund account, called a substitution account.* This would be done in a single, special issue of bancor. In this way countries with excessive dollars can get what effectively amounts to an exchange rate guarantee. The interest rate on bancor would obviously influence the extent of conversion, and it is partly to encourage such conversion that we suggest the interest rate be raised well above the present 1 ½ percent on SDRs.

The International Monetary Fund in turn would work out a mutually satisfactory arrangement with the United States to cover the exchange risk on the dollars that it acquired and to provide for their amortization over a suitably long period of time. Those countries that desire to hold dollars could continue to do so, but they would be under no pressure to hold dollars; thus it could be assumed that after consolidation all dollars remaining outstanding were willingly held.

This arrangement alone, while removing a major burden overhanging exchange markets, would not be able to deal with the problem of large conversions of private or remaining official dollar balances into other currencies in a short period of time. Under the renovated system, the United States would be obliged to convert any such dollars into re-

serve assets on demand; but it might not have reserve assets adequate to this task. One possibility would be to allow the dollar, or any currency under similar pressure, to float freely downward under such circumstances. But, by general agreement, such depreciation might not always be desirable. *It is therefore necessary to provide for large and rapid short-term lending to countries suddenly confronted with a conversion requirement which they cannot meet out of reserves and which it would be unadvisable to meet through exchange rate adjustment.* While this lending facility could be simply an enlargement of the present central bank swap facilities, we prefer a more formal institutional arrangement which in effect multilateralizes the swaps and lodges them within the International Monetary Fund, making it a true lender of last resort, a central bank for central banks.

This new facility would lend quickly and on short term any amount that a country seemed to require to defend an exchange rate that was threatened by a massive movement of funds. If, as would usually be the case, the movement of funds proved to be temporary, the borrowing country would repay the IMF as the reversals occurred. These loans might bear a high interest rate for the purpose of encouraging prompt repayment as well.

This type of emergency lending would not in principle be available to finance basic balance of payments deficits. But of course at the time of a massive movement of funds it is not generally possible to distinguish one type of funds from another. Where it is clear that the movement of funds is due to a basic balance of payments deficit the lending authorities could decline to lend. But generally the lending should be available to cover any type of massive switch from one currency to another, including a switch made by the residents of the country experiencing the run. If after a large flow it was learned that a portion of it was due to a worsening of the country's balance of payments position, then the country would be obliged to repay the IMF for any unwarranted borrowing, if necessary by drawing on the normal lending facilities of the IMF based on quotas which would continue to function as now, and to take corrective steps.

If, on the other hand, the switch of funds or some part of it proved to be a lasting phenomenon, and not arising from a basic payments deficit, the short-term obligation that the borrowing country had incurred to the lending facility could be converted into a long-term in-

terest-bearing debt with a fixed amortization schedule over a suitably long period of time. This in effect would represent a delayed consolidation operation of the type described above. The interest and amortization payments would be normal international payments and would, other things being equal, trigger the reformed adjustment process to allow the country to run the required surplus in its other international payments to repay the debt. The maturity would be sufficiently long, 40 years for example, so that the debt amortization would not unduly strain the adjustment process.

Such a facility would have special relevance to the United States because of the very large amount of dollars held abroad in private hands. But Britain would also benefit, for private sterling balances remain large, and increasing amounts of such other currencies as German marks, Swiss francs, and Japanese yen are being held by nonresidents. So the problem is becoming a more general one and this new facility would offer a general solution. Moreover, we should not forget the even larger private resident balances in every currency. „While movements abroad of resident funds are more readily subject to capital controls than is true for nonresident funds, large movement of such resident funds will nonetheless be possible in practice, as both France and Italy have learned in recent years, despite controls. Unless national reserves are to be large enough to cope with this contingency in the face of growing knowledge by the public everywhere of foreign exchange transactions, the lender-of-last-resort function would also cover such movements, which, of course, would be largely reversible.

4. Economic Interdependence

Even with improvements along the lines suggested above, the major industrial countries would be left with the problem of growing economic interdependence, which links national economies together ever more tightly. A beneficial division of labor is permitted by this growing interdependence, but it also leads to new constraints on national economic policy. The effectiveness of much national economic policy depends to a considerable degree on the insulation of the national economy from the world economy. As mobility of goods, funds, and factors of production increases, this insulation becomes thinner and thinner, and divergences in national economic policies lead to private responses that at once may create disturbances to other countries and erode the effectiveness of the policies of the country in question.

The most obvious and acute area where these developments have occurred is monetary policy. With increasingly mobile private funds, a country pursuing easy monetary policy finds itself simply encouraging a capital outflow, while a country trying to tighten up domestic monetary conditions simply encourages a capital inflow. Yet these very flows undercut the domestic purposes of monetary policy. Inflows of funds from abroad erode a government's capacity to tighten monetary conditions and damp down domestic demand, for example. In addition, the independent pursuit of national monetary policy may cause severe disturbances in other countries. An attempt by one country to tighten up its monetary conditions may lead to a competitive rise in interest rates. The dominance of large countries in this regard is especially felt and resented.

At the same time, so long as national economies are not fully integrated, nations will need to preserve some autonomy in national policy. Exchange rate flexibility within a band around parities will provide some of this necessary insulation between national economies, but not enough. Controls on capital movements represent an alternative, and they indeed can also provide some insulation between national economies. But as mobility increases further, any given set of controls becomes less and less workable. To provide insulation the controls must be extended to ever greater numbers of transactions, and the process of this extension will cut down the manifold advantages of an economic environment relatively free of controls. *We believe the appropriate course of action is for all industrial countries to shift the emphasis in domestic stabilization policy from monetary to fiscal measures*, where the impact on domestic economic activity continues to be high. In particular, *governments that do not have it need to be given the authority to move quickly and in the required degree to ease or tighten fiscal conditions*, and all governments need also to be charged with the responsibility for using fiscal policy flexibility

In this way, divergences in national monetary policy need not be nearly so great as they have been in the past, and over the course of time the industrial nations can evolve a common monetary policy for the world community as a whole. We recognize, however, that the evolution toward flexible fiscal policy and a common monetary policy will be slow, for existing practices and constraints vary markedly from country to country.

5. The Institutional Setting

Many of the arrangements discussed above could be agreed and implemented among the major industrial countries alone. Because of their size and economic importance, their cooperation on these issues is Essential. But other countries also have a vital interest in the evolution of the world economy, and as time passes a number of countries that are now economically “small” will grow in relative importance. For these reasons, *we believe a serious attempt should be made to lodge responsibility for overseeing and in some cases managing the improvements sketched above in an international institution, most logically a revamped International Monetary Fund.* But the Fund must be given more authority than it now has in guiding balance of payments adjustment, it must be capable of responding to financial need more quickly and in much larger magnitude than it is now able to do, and it must involve more actively the top policymakers of the leading countries.

To accomplish this, we propose that the “Deputies” of the Ministerial Committee of Twenty, made up of top sub-cabinet monetary officials from national governments, be given a permanent place in the structure of the International Monetary Fund. They would meet as often as needed, at least six times a year, for the purpose of overseeing the renovated adjustment process and evaluating the use of the lender-of-last-resort facility, with assistance from the International Monetary Fund staff. Large countries have particular responsibility for assuring a smooth operation of the international monetary system. The relative importance of countries in the Fund should not be frozen, however; it should reflect and respond to changes in their relative importance in the world economy.

Present operations of the International Monetary Fund, including periodic review of national economic conditions, conditional lending for balance of payments support, and responsibility for evaluating the secular growth of world liquidity and proposing additions to it, would continue.

IV.

RISKS INHERENT IN THE PRESENT SITUATION

What are the consequences of failing to renovate the international monetary system quickly enough along the lines indicated above? We have attempted to suggest in general terms what a reformed system would look like. We have not provided a fully worked-out plan, however. A number of the suggested measures have functional equivalents, so a renovated system need not take the precise form we have outlined. But we have identified the basic issues that must be dealt with. This section concerns the risks of not dealing with them all. What are the dangers arising from simply allowing major currencies to “float” against one another as they have done in the period following March 1973, confirming the complete breakdown of the Bretton Woods system?

We have identified above the weaknesses of the Bretton Woods payments system as it evolved in practice. We are well aware of the weaknesses of a system in which exchange rates are too rigidly fixed. However, at the present time, we are in a period in which exchange rates are generally “floating” with ad hoc and uncoordinated intervention by central banks, each on its own volition. That system also has its weaknesses and dangers. We do not believe that the renovated system we propose can come into being quickly. We therefore must address the consequences of simply carrying on with present arrangements. The risks will, of course, vary substantially from country to country, in view of their different circumstances. Some countries will find the present arrangements far more tolerable, and even favorable, than others. But we do not believe that the present arrangements are durable, and we offer our reasons here. Some observers will view them as exaggerated, but we are citing risks, not certainties; and we believe the risks to be real, even if not certain to come about.

The first risk, as we learned in mid-1973, is that “floating” exchange rates will be subject to many pressures that are irrelevant to the preservation of equilibrium in a country’s international payments, but will nevertheless cause disturbance to normal trade flows and through them to domestic economies, dependent on international trade as all our economies are today. Sharp movements in exchange rates unwarranted by fundamental economic considerations can occur in any currency, but they are especially likely where, as in the case of the dollar, sterling, the

German mark, and the Swiss franc, outstanding holdings of the currency are large relative to international transactions in these currencies. (Of course, once allowance is made for large resident holdings of national currencies, this problem potentially becomes a general one. But conditions must usually deteriorate enormously before there is a wholesale speculation by residents against their own currency.) In these cases large movements in an exchange rate may take place in response to relatively small shifts in or out of the currency, and such shifts may well be governed by psychological or political factors affecting confidence” in the currency and by subjective assessments of what other holders will do next rather than by fundamental economic factors that determine the strength of a currency over a longer period of time. Yet sharp shifts in exchange rates can have important ramifications for those whose livelihood depends on trade or on financial transactions with foreigners.

Modern governments, responsible for national economic developments, cannot allow arbitrary disturbances to impinge on domestic business activity through the exchange rate. They are likely to take steps to protect the domestic economy from these disturbances. They may do this by intervening in the foreign exchange market to restrict movements of the exchange rate. But an exchange rate is intrinsically two-sided and two countries may take very different views on what their common exchange rate should be. If so, they will intervene in the exchange market at cross purposes, and neither will wholly succeed. In the absence of some form of cooperation, countries will turn to other measures to provide the necessary protection. They may also turn to other measures to avoid having to take an exchange risk on foreign exchange reserves that would have to be acquired and held in connection with exchange market intervention. A country that desires to avoid appreciation of its currency would impose controls on the importation of capital and possibly on the export of goods. A country that wants to neutralize the trade and employment effects of what it regards as an under-valued currency would impose controls on imports from the country with the undervalued currency. These actions would be taken to protect the viability of domestic firms against what is perceived as predatory increases in foreign competitiveness transmitted through the exchange market. By assumption, these actions would take place in a context where coordination with other countries would be minimal. There would be no procedure for resolving conflicts in national objectives or inconsisten-

cies in the national use of instruments of policy. The whole point of an agreed set of rules is to assure the *mutual* benefits that accrue in an orderly system as compared with a disorderly one.

A proliferation of controls on trade and capital movements would damage not only the direct participants, but third parties as well. In particular, developing countries would suffer great damage in an environment in which major are competing with one another to erect barriers 'to trade and capital movements, just as they bore the brunt of a number of measures, such as tied aid, that were taken to protect overvalued currencies when exchange rates were too rigid. We do *not* see the danger of a major depression. Modern governments are too sensitive to unemployment to allow that to happen. What we do fear is a widespread use of controls on international transactions precisely to assure the autonomy governments may feel necessary to preserve national employment.

While we do not see a world depression, we do believe that such an evolution could result in major economic dislocations and in reduced standards of living. There would be temporary unemployment in those activities most heavily dependent on foreign trade. The standard of economic well-being would decline for all, relative to what it would other-wise be, but it would decline especially for those countries, which includes many of the developing countries, which are the most dependent upon foreign trade and the most vulnerable to major disturbances in the world economy. There have been sufficient steps in the direction of this evolution already to suggest that is not merely a chimerical danger. Controls on capital movements greatly proliferated during the currency disturbances of the past several years, especially while currencies were floating, and trade controls have been threatened.

There are two further risks. One is that anxiety about currencies arising from disturbances in the foreign exchange market may be contagious, and may reduce confidence by residents in their own currencies as well. This development could lead to a general erosion of confidence in nationally-managed money, a development of inflationary potential which national authorities alone might be unable to identify and correct.

The other risk is that a general deterioration of economic relations among countries will poison their relations in noneconomic areas as well. Of all the areas of international relations, economics touches most directly on the majority of people. In an environment of mutual and retaliatory defensive action between nations, malign feelings toward

“foreigners” are bound to develop, and in democracies such feelings can act as a powerful constraining factor on chief executives to pursue constructive courses of action, noneconomic as well as economic, with other nations. Thus we believe a satisfactory and well-functioning international monetary system is a necessary if not alone a sufficient condition for harmonious international relations in all areas. During the period of 1971-1973 acrimony over monetary issues has risen alarmingly and we have flirted unwittingly with the high risk of undoing the vast gains of the preceding two decades in welding together at least the beginning of an international community among the non-communist industrial nations of the world.

V.

INTERIM PRIORITIES AND TRANSITIONAL MEASURES

It will take several years, at best, to negotiate, formulate in legal terms, and ratify many of the proposed elements of the renovated system. Many untoward developments could occur during this transitional period. The experience of early 1973 is disquieting as regards the smooth functioning of the world economy without generally accepted financial rules. While the negotiations go forward, therefore, we need in addition to take steps to bridge the interim period and to establish the basis for the renovated system. These transitional measures are designated to restore a degree of calm and stability to currency and financial markets and to provide an environment of cooperation rather than contention in which the negotiations on longer-term measures can take place. We suggest five interrelated measures to be taken with a high sense of urgency:

1. coordination of intervention in exchange markets;
2. consolidation of some outstanding dollar balances;
3. enlargement of short-term lending facilities;
4. commitment to and control of the euro-currency market;
5. definition of a gold policy.

1. Exchange Market Intervention

Governments have repeatedly stated their belief that the exchange rates established in February 1973 were appropriate, with minor adjustments. Yet speculative pressures in exchange markets pushed exchange rates well away from that pattern, and also provided sharp and erratic day-to-day movements in rates. It would not be realistic to attempt to restore the February 1973 pattern of rates by central bank interventions in the market. But *the monetary authorities should state their unwillingness to see exchange rates battered about by momentary sentiments influencing the holders of volatile liquid funds. They should intervene in the markets, on a cooperative basis, in sufficient force to smooth out movements in exchange rates.* This kind of braking action, along with other interim measures discussed below, should be sufficient to influence private ex-

pectations about future movements in exchange rates, and to lead to an unwinding of the heavy speculative positions against the dollar.

We feel that the problem of “burden-sharing” in defending a currency which is depreciating has received more emphasis than it deserves. We support the rule of thumb that has apparently been adopted in the mid-1973 Basel agreements, that is, of splitting evenly between the debtor and the creditor central banks the costs of exchange losses that arise when borrowed funds are used in exchange market support operations. But profit and loss considerations should not play a large role in a central bank’s attitude when such a basic economic variable as its exchange rate is at stake.

2. Consolidation of Foreign Exchange Balances

An important psychological depressant in the market for dollars has been the large outstanding official balances of dollars, balances that tripled in the two years 1971 and 1972 and grew by a further \$13 billion in the first ten weeks of 1973, before the inauguration of floating. The act of floating itself demonstrated an unwillingness of many countries to add further to their dollar balances, even when they felt that the dollar had become an under-valued currency. This depressing factor can be relieved by steps to consolidate at least some of the dollar balances. (These arguments also apply, with less force, to outstanding official balances in sterling.)

Full consolidation in exchange for bancor, the revamped SDR, must await the longer-range reforms, including amendment of the Articles of the International Monetary Fund. But *some interim consolidation should be undertaken through a series of agreements between the United States and the largest creditor nations* under terms and conditions that are agreed among all the parties directly involved. The United States would provide an exchange guarantee on the balances in question, most appropriately by denominating them in units of account equivalent to the SDR. To this end, it would be essential to agree on the exact definition of the revamped SDR in the interim period, preferably along the lines we have recommended above, even before formal legislation can be obtained. Such agreement would permit use of the new unit of account. In addition, the United States would agree to amortize these balances over suitably long period of time, chosen so that the interest and amortization payments together would not differ greatly from interest payments

on outstanding dollar balances. Thus the amortization would not require unacceptably large U.S. surpluses in other transactions.

In exchange, creditor nations would accept a rate of interest appropriate to the guaranteed asset, and they would agree not to use the claims for any purpose, except under extreme balance of payments pressure, under which circumstances by agreement their liquidity might be restored.

Not all dollar balances should be handled in this way, for dollar holdings will remain during the transitional period the most usable form duly of international liquidity. But if a substantial share of the “overhang” could be funded, there would be salutary effects on market psychology. The amounts so funded could be taken over by the IMF substitution account when it began operation, and such conversion would of course restore the liquidity of the asset to the creditors.

3. Short-term Lending Facilities

Market intervention, especially in the face of the massive movements of funds that became commonplace in the past two years, may require substantial amounts of foreign currencies. This obviously poses no problem for those countries that have amassed huge dollar reserves and who must intervene by selling dollars. But it does pose problems for the United States, which holds virtually no foreign exchange, and even for those countries with large dollar holdings who find they must intervene in the market for some other currency and do not want to disturb the for dollars in the process.

To accommodate this possible need, large short-term credit facilities between central banks are necessary – an antecedent to the lender of last resort we have urged for the renovated international monetary system. We already have a network of central bank swap facilities, which perform this function at present. But *that network should be improved in three ways*. First, it should be further enlarged. The increase of the Federal Reserve bilateral swap arrangements to a total of \$17 billion in July 1973 – with a maximum of \$2 billion for a single currency is – not sufficient in a time when \$2 billion can move into a given currency on a single day. Second, the network should be multilateralized, so that the actions of any pair of countries is under the surveillance of the community of nations, but not in such a way as to impede the speed of providing credits when necessary. Furthermore, credit facilities should

be made available to other leading countries, as they already have been to some degree within the European Community. The arrangements should be designed to merge smoothly into the IMF lender-of-last-resort facility to be created as part of the longer-run renovation of the system. Third, a more systematic process should be established for extending credits that are not reversed through market forces in a relatively short period of time. These credits should become eligible for the consolidation arrangements discussed above, if necessary accompanied by any adjustment measures that may be necessary to prevent continuing calls on credit by a single country.

4. Surveillance of the Eurocurrency Market

The eurocurrency market is a much maligned feature of the international monetary system as it has evolved in the past decade. Many of the disturbances of the past few years have been attributed to it. But in fact the eurocurrency market is itself a symptom of some of those same forces that are responsible for the disturbances – national disequilibria combined with greatly increased mobility of capital. And the euro-currency market has served the positive function of providing a genuine international market for money and credit that can readily and at low cost mobilize the savings of the world and channel them to productive investors. It represents the healthy beginning of a restoration of a true international capital market.

At the same time, there can be little doubt that the presence of the euro-currency market has made it easier to move funds from one currency to another on a massive scale than would have been possible in its absence; and there can also be little doubt that the rapid and largely uncontrolled growth of the euro~currency market has become a source of uneasiness in financial circles and among large holders of currencies. In the absence of outside review and standards for euro-banks, it may be that the standards of credit-worthiness applied to borrowers have declined markedly in the face of growing competition among participants in the market, raising the spectre of an old-fashioned collapse of the pyramid of credit that has developed in this new banking system.

We believe that the eurocurrency market has greater resiliency than pessimistic observers contend. But we also believe that growing uneasiness would be considerably allayed *if the leading central banks jointly declared their readiness to stand squarely behind the euro-currency*

market in the event of major withdrawals by depositors. The commitment itself would help to obviate the need to honor it. In addition, the leading central banks should announce their intention, jointly and in cooperation, to study carefully the books of banks participating in the euro-currency market, holding out the possibility that some limits might be placed either on the asset side or on the liability side of their balance sheets if that were found to be desirable limits analogous to reserve requirements or lending constraints typically found in domestic banking systems. This action would reinforce the salutary psychological impact of the commitment to stand behind the market in time of crisis, and by putting banks on notice that joint control was possible would itself introduce a new cautionary dimension into lending and borrowing decisions.

5. Gold Policy

The price of gold has evoked an attention out of all proportion to its real importance. We have already made clear our belief that new reserves have to be created by joint decisions in the form of bancor and not in the form of national currencies. Establishing an official higher price of gold would clearly be inconsistent with our view that bancor should constitute the principal reserve asset, increasing in importance over time. Indeed, we look eventually to the gradual abandonment of gold as an official monetary medium, although no doubt some gold will continue to be officially held as a contingency reserve, just as other real commodities are stockpiled by several countries today.

However, the day of the monetary unimportance of gold is still some time away. In the meantime, gold indisputably does attract attention in financial circles. *We believe an action consonant with our long-run objectives and at the same time advancing the interim aim of calming markets would be the coordinated and joint sale of official gold into private markets.* Such sales would require suppression of the March 1968 agreement to separate official from private gold transactions on the selling side. Sales should not aim to depress the market price greatly, but if moderate sales did so, that would be welcome. In recent years, the purchase of gold has seemed to provide a foolproof way to increase wealth. The official sale of gold, without a predetermined price, would interject much uncertainty into the gold market and would thus encourage funds to shift back to other assets and would help to restore confidence in currencies.

Official sales of gold would raise questions about the treatment of any discrepancy in price between the present official price and the market sales price. By their own testimony, central banks do not generally need additional reserves. The sales into private markets, other things being equal, would have a deflationary impact on the world economy by reducing purchasing power in private hands. We believe that the “capital gains” of central banks on gold sales would represent an attractive source, during the transitional period, of development assistance. The amounts could be consequential: sales of \$3 billion in official gold could possibly raise twice that on the private market. Gold sales would represent a fiscally sound way to raise financial assistance, preferable in this respect to a link between SDR-creation and development assistance such as has been discussed by the Committee of Twenty. Still better, of course, would be a contributory system based on agreed principles of taxation in the rich countries of the world, but as a practical matter that falls well outside the transitional period we are now discussing. Gold sales in an agreed total amount could be apportioned among all countries for which gold accounted, say, for more than 10 percent of total reserves, in proportion to their excess holdings.

These five steps, taken together, represent concrete actions to bring the international monetary system back under control and, even more important, to do it in a way that indicates the willingness of the leading countries of the non-communist world to work together in a joint enterprise beneficial to all.

(As of November 1, 1973)

Members of the Trilateral Commission

GERARD C. SMITH <i>North American Chairman</i>	TAKESHI WATANABE <i>Japanese Chairman</i>	MAX KOHNSTAMM <i>European Chairman</i>
--	---	--

ZBIGNIEW BRZEZINSKI
Director

GEORGE S. FRANKLIN
North American Secretary

WOLFGANG HAGER
European Secretary

TADASHI YAMAMOTO
Japanese Secretary

North American Members

*I. W. Abel, *President, United Steelworkers of America*
David M. Abshire, *Chairman, Georgetown University Center for Strategic and International Studies*
Graham Allison, *Professor of Politics, Harvard University*
Doris Anderson, *Editor, Chatelaine Magazine*
John B. Anderson, *House of Representatives*
Ernest C. Arbuckle, *Chairman, Wells Fargo Bank*
J. Paul Austin, *Chairman, The Coca-Cola Company*
George W. Ball, *Senior Partner, Lehman Brothers*
Russell Bell, *Research Director, Canadian Labour Congress*
Lucy Wilson Benson, *President, League of Women Voters of the United States*
W. Michael Blumenthal, *Chairman, Bendix Corporation*
Bernard Benin, *Director, Institut d'Economie appliquée, Ecole des Hautes Etudes Commerciales*
*Robert W. Bonner, Q.C., *Chairman, MacMillan Bloedel, Ltd.*
Robert R. Bowie, *Clarence Dillon Professor of International Affairs, Harvard University*
*Harold Brown, *President, California Institute of Technology*
James E. Carter, Jr., *Governor of Georgia*
Lawton Chiles, *United States Senate*
Warren Christopher, *Partner, O'Melveny & Myers*
Alden W. Clausen, *President, Bank of America*
William T. Coleman, Jr., *Senior Partner, Dilworth, Paxson, Kalish, Levy & Coleman*
Barber B. Conable, Jr., *House of Representatives*
Richard N. Cooper, *Provost and Frank Altschul Professor of International Economics, Yale University*
John C. Culver, *House of Representatives*
Lloyd N. Cutler, *Partner, Wilmer, Cutler & Pickering*

*Executive Committee

Archibald K. Davis, *Chairman, Wachovia Bank & Trust Company*
 Emmett Dedmon, *Vice President and Editorial Director, Field Enterprises, Inc.*
 Hedley Donovan, *Editor-in-Chief, Time, Inc.*
 Daniel J. Evans, *Governor of Washington*
 Gordon Fairweather, *Member of Parliament*
 *Patrick E. Haggerty, *Chairman, Texas Instruments*
 William A. Hewitt, *Chairman, Deere & Company*
 Alan Hockin, *Executive Vice President, Toronto-Dominion Bank*
 Thomas L. Hughes, *President, Carnegie Endowment for International Peace*
 Edgar F. Kaiser, *Chairman, Kaiser Industries Corporation*
 Lane Kirkland, *Secretary-Treasurer, AFL-CIO*
 Bruce K. MacLaury, *President, Federal Reserve Bank of Minneapolis*
 Paul W. McCracken, *Edmund Ezra Day Professor of Business Administration, University of Michigan*
 Wilbur D. Mills, *House of Representatives*
 Walter F. Mondale, *United States Senate*
 Lee L. Morgan, *President, Caterpillar Tractor Company*
 J. R. Murray, *Former Managing Director, Hudson's Bay Company,*
 Kenneth D. Naden, *Executive Vice President, National Council of Farmer Cooperatives*
 Henry D. Owen, *Director, Foreign Policy Studies Program, the Brookings Institution*
 David Packard, *Chairman, Hewlett-Packard Company*
 Jean-Luc Pepin, P.C., *President, Interimco, Ltd.*
 John H. Perkins, *President, Continental Illinois National Bank & Trust Company*
 Peter G. Peterson, *Chairman, Lehman Brothers*
 Edwin O. Reischauer, *University Professor, Harvard University; former U.S. Ambassador to Japan*
 Charles W. Robinson, *President, Marcona Corporation*
 David Rockefeller, *Chairman, Chase Manhattan Bank*
 Robert V. Roosa, *Partner, Brown Bros., Harriman & Company*
 William M. Roth, *Roth Properties*
 William V. Roth, Jr., *United States Senate*
 Carl T. Rowan, *Columnist*
 William W. Scranton, *Former Governor of Pennsylvania*
 Gerard C. Smith, *Counsel, Wilmer, Cutler & Pickering*
 Anthony Solomon, *Consultant*
 Robert Taft, Jr., *United States Senate*
 Arthur R. Taylor, *President, Columbia Broadcasting System, Inc.*
 Cyrus R. Vance, *Partner, Simpson, Thacher & Bartlett*
 Paul C. Wamke, *Partner, Clifford, Wamke, Glass, McIlwain & Finney*
 Marina von N. Whitman, *Distinguished Public Service Professor of Economics, University of Pittsburgh*
 Carroll L. Wilson, *Professor of Management, Alfred P. Sloan School of Management, MIT*
 Arthur M. Wood, *President, Sears, Roebuck & Company*
 Leonard Woodcock, *President, United Automobile Workers*

*Executive Committee

European Members

*Giovanni Agnelli, President, FIA T, Ltd.
*P. Nyboe Andersen, Member of the Danish Parliament
*Klaus Dieter Arndt, Member of the Bundestag
Raymond Barre, Former Vice President of the Commission of the European Community
Piero Bassetti, President of the Regional Government of Lombardy
Georges Berthoin, Former Chief Representative of the Commission of the European Community to the U.K.
*Kurt Birrenbach, Member of the Bundestag; President, Thyssen Vermögensverwaltung
Franco Bobba, Company Director, Turin
Jean Boissonat, Editor-in-Chief, L'Expansion
Frederick Boland, Chancellor, Dublin University; former President of the United Nations General Assembly
Alastair Burnet, Editor, The Economist
Jean-Claude Casanova, Director of Studies, Fondation Nationale des Sciences Politiques
Umberto Colombo, Director of the Committee for Scientific Policy, OECD
Guido Colonna di Paliano, President, La Rinascente; former member of the Commission of the European Community *
Francesco Compagna, UnderSecretary of State, Ministry of the Mezzogiorno
Jacques de Fouchier, President, Banque de Paris et des Pays Bas
Paul Delouvrier, Chairman, French Electricity Board
Barry Desmond, Member of the Lower House of the Irish Republic
Wemer Dollinger, Member of the Bundestag
*Marc Eyskens, Commissary General of the Catholic University of Louvain
R. Ewalenko, Director of the Belgium National Bank
Francesco Forte, Professor of Financial Sciences, University of Turin
Sir Reay Geddes, Chairman, Dunlop Holdings, Ltd.
Giuseppe Glisenti, Director of General Affairs, La Rinascente
Karl Hauenschild, President, German Chemical-Paper-Ceramics Workers' Union
Jozef P. Houthuys, President, Belgian Confederation of Christian Trade Unions
Daniel E. Janssen, Deputy Director General, Belgian Chemical Union, Ltd.
Roy Jenkins, Member of Parliament
Karl Kaiser, Director of the Research Institute of the German Society for Foreign Policy
Michael Killeen, Managing Director, Industrial Development Authority, Irish Republic
André Kloos, Chairman of the Socialist radio and television network "V.A.R.A" former chairman of the Dutch Trade Union Federation
*Max Kohnstamm, President, European Community Institute for University Studies
Baron Léon Lambert, President, Banque Lambert, Brussels
Count Otto Lambsdorff, Member of the Bundestag
Arrigo Levi, Director, La Stampa, Turin

*Executive Committee

Eugen Loderer, President, German Metal Workers' Union
 *John Loudon, President, Royal Dutch Shell Group
 Robert Marjolin, Former Vice President of the Commission of the European Community
 Reginald Maudling, Member of Parliament; former Cabinet Minister
 Cesare Merlini, Director, Italian Institute for International Affairs
 Alwin Münchmeyer, President, German Banking Federation
 Michael O'Kennedy, Shadow Minister of Foreign Affairs, Irish Republic; former Cabinet Minister
 Pierre Pescatore, Luxembourg; Member of the European Court of Justice
 Julian Ridsdale, Member of Parliament; Chairman of the Anglo-Japanese Parliament Group
 Sir Frank K. Roberts, Advisory Director of Unilever, Ltd.; Advisor on International Affairs to Lloyds of London
 *Mary T. W. Robinson, Member of the Senate of the Irish Republic
 Sir Eric Roll, Executive Director, S. G. Warburg and Company
 John Christian Sannes, Director, Norwegian Institute of International Affairs
 Gerhard Schröder, Member of the Bundestag; former Foreign Minister of the Federal Republic of Germany
 Roger Seydoux, Ambassador of France; President, Banque de Madagascar
 Hans-Günther Sohl, President, Federal Union of German Industry; President of the Board of Directors of August Thyssen Hütte A.G.
 Theo Sommer, Editor-in-Chief, Die Zeit
 Myles Staunton, Member of the Lower House of the Irish Republic
 Thorvald Stoltenberg, International Affairs Secretary, Norwegian Trade Union Council
 *Otto Grieg Tidemand, Shipowner; former Norwegian Minister of Defense and Minister of Economic Affairs
 Heinz-Oskar Vetter, Chairman, German Federation of Trade Unions
 Otto Wolff von Amerongen, President, Otto Wolff A.G.; President, German Chamber of Commerce
 *Sir Kenneth Younger, Former Director of the Royal Institute of International Affairs; former Minister of State for Foreign Affairs
 *Sir Philip de Zulueta, Chief-Executive, Antony Gibbs and Sons; former Chief Assistant to the British Prime Minister

Japanese Members

Isao Amagi, Director, Japan Scholarship Foundation; former Vice Minister of Education
 Yoshiya Ariyoshi, Chairman, Nippon Yusen Kaisha
 Yoshishige Ashihara, Chairman, Kansai Electric Power Company, Inc.
 Toshio Doko, Chairman, Tokyo Shibaura Electric Company, Ltd.
 Jun Eto, Professor, Tokyo Institute of Technology
 Shinkichi Eto, Professor of International Relations, Tokyo University
 *Chujiro Fujino, President, Mitsubishi Corporation

*Executive Committee

Shintaro Fukushima, President, Kyodo News Service
 Noboru Gotoh, President, TOKYU Corporation
 Toru Hagiwara, Advisor to the Minister of Foreign Affairs; former Ambassador to France
 Sumio Hara, Chairman, Bank of Tokyo, Ltd.
 *Yukitaka Haraguchi, Chairman, All Japan Federation of Metal and Mining Industries Labor Unions
 Norishige Hasegawa, President, Sumitomo Chemical Company, Ltd.
 Teru Hidaka, Chairman, Yamaichi Securities Company, Ltd.
 *Kazushige Hirasawa, Radio-TV news commentator, Japan Broadcasting Inc.
 Hideo Hori, President, Employment Promotion Project Corporation
 Teizo Horikoshi, Vice President, Japan Federation of Economic Organizations (Keidanren)
 Shozo Hotta, Chairman, Sumitomo Bank, Ltd.
 Shinichi Ichimura, Professor of Economics, Kyoto University
 Hiroki Imazato, President, Nippon Seiko K.K.
 Yoshihiro Inayama, Chairman, Nippon Steel Corporation
 Kaoru Inoue, Chairman, Kangyo Bank, Ltd.
 Rokuro Ishikawa, Executive Vice President, Kajima Corporation
 Tadao Ishikawa, Professor, Department of Political Science, Keio University
 Yoshizane Iwasa, Chairman of the Advisory Committee, Fuji Bank, Ltd.
 Motoo Kaji, Professor of American Studies, Tokyo University
 Fuji Kamiya, Professor, Keio University
 *Yusuke Kashiwagi, Deputy President, Bank of Tokyo, Ltd.; former Special Advisor to the Minister of Finance
 Ryoichi Kawai, President, Komatsu Seisakusho, Ltd.
 Katsuji Kawamata, Chairman, Nissan Motor Company, Ltd.
 Kazutaka Kikawada, Chairman, Tokyo Electric Power Company, Inc.
 Kiichiro Kitaura, President, Nomura Securities Company, Ltd.
 Koji Kobayashi, President, Nippon Electric Company, Ltd.
 Kenichiro Komai, Chairman, Hitachi, Ltd.
 Fumihiko Kono, Counselor, Mitsubishi Heavy Industries, Ltd.
 Masataka Kosaka, Professor, Faculty of Law, Kyoto University
 Fumihiko Maki, Principal Partner, Maki and Associates, Design, Planning and Development
 Shigeharu Matsumoto, Chairman, International House of Japan, Inc.
 Masaharu Matsushita, President, Matsushita Electric Company, Ltd.
 *Kiichi Miyazawa, Member of the Diet; former Minister of International Trade and Industry
 Akio Morita, President, Sony Corporation
 Takashi Mukaibo, Professor, Faculty of Engineering, Tokyo University
 *Kinhide Mushakoji, Director, Institute of International Relations, Sophia University
 Yonosuke Nagai, Professor of Political Science, Tokyo Institute of Technology
 Shigeo Nagano, Counselor, Japan Development Bank
 Eiichi Nagasue, Member of the Diet
 Toshio Nakamura, President, Mitsubishi Bank, Ltd.

*Executive Committee

Ichiro Nakayama, President, Japan Institute of Labor
 Sohei Nakayama, President, Overseas Technical Cooperation Agency
 Yoshihisa Ohjimi, Advisor, Arabian Oil Company, Ltd.; former Administrative _ Vice
 Minister of International Trade and Industry
 *Saburo Okita, President, Overseas Economic Cooperation Fund
 Kiichi Saeki, Director, Nomura Research Institute of Technology and Economics
 Kunihiro Sasaki, Chairman, Fuji Bank, Ltd.
 Kiichiro Sato, Counselor, Mitsui Bank, Ltd.
 *Ryuji Takeuchi, Advisor to the Ministry of Foreign Affairs; former Ambassador to the
 United States
 Eiji Toyoda, President, Toyota Motor Company, Ltd.
 Seiji Tsutsumi, President, Seibu Department Store, Inc.
 Kogoro Uemura, President, Japan Federation of Economic Organizations (Keidanren)
 Tadao Umezao, Professor of Ethnology, Kyoto University
 Jiro Ushio, President, Ushio Electric Inc.
 Shogo Watanabe, President, Nikko Securities Company, Ltd.
 *Takeshi Watanabe, Chairman, Trident International Finance, Ltd., Hong Kong;
 former President, the Asian Development Bank .
 Kizo Yasui, Chairman, Toray Industries, Inc.

*Executive Committee