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MYTHS AND REALITY IN THE DEVELOPMENT OF INTERNATIONAL MONETARY AFFAIRS

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INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS

PRINCETON UNIVERSITY

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Myths and Reality in the Development of International Monetary Affairs*

1 Discovering the Lesson of History

Documents attempting to establish a monetary order are like written constitutions. Produced with difficulty, often under dramatic circumstances, they reflect little more than a superficial consensus inspired by passing circumstances. Within a short time, events impose an unexpected pattern on the relationships that were supposed to be regulated. The monetary history of the modern era offers a smaller store of experience than its constitutional history, but it provides even clearer illustrations of the gap between documents and reality.

For the first time since the Church had ceased to concern itself with the matter several centuries before, a collective effort was mounted after World War I to establish an international monetary order. A false doctrine (albeit so deeply held that it has followers even today) maintained that the gold standard had been one of the essential elements of the lost paradise of the prewar world. An important characteristic of this system, at least as it was supposed to have existed, was the equality of national currencies before the "law of gold." Whether these currencies were issued by large or by small nations, the "law" was the same for all. It was deemed to derive from the natural order, like the laws of physics, and was in no way inconsistent with national sovereignty. This equality of rights and obligations for currencies is nowadays called "symmetry"; the word is new, but the illusion it represents has a venerable history. At a time when the economic, monetary, and political phenomena of the modern world were little understood, it was natural that people should want to reestablish the gold standard; it was the only system that had ever been devised and was identified with a certain economic, social, and political order that was considered the only proper one.

This doomed enterprise was launched at the monetary conferences of the League of Nations, particularly at the meetings of its Gold Delegation. With the advantage of hindsight, we can now see why it was impossible, even with a few modernizations, to recreate in the twentieth

* This essay was written (originally in French) during the Christmas holidays of 1973, just before the emergence of certain relevant developments. These developments —the further crippling of the European "snake," caused by the floating of the French franc, and the Rome Conference of the Committee of Twenty on International Monetary Reform—are briefly reviewed in a postscript.

century a system that worked in the eighteenth century and for a part of the nineteenth. First, it had worked much less perfectly than was imagined before studies were produced by a galaxy of economists (Gide, Bloomfield, Triffin, Lindert, Ford, Mundell, *et al.*). Second, the system had in fact been in abeyance for some decades as a consequence of the financial needs of an economic expansion that was more rapid than the growth in gold output and, even more, as a consequence of the invention of the telegraph and the development of political democracy.

The outcome of these efforts was christened the "gold-exchange standard." In practice, this meant an extension of the sterling area, which had grown out of the administrative and economic arrangements of the British Empire in the nineteenth century and was about to spread over most of the world, since it was now to embrace almost all the countries of Europe, including France. The transformation of the sterling system went some way toward meeting a need never before encountered for an international currency other than "clinking gold coins." Since past experience gave no useful guidance, people could hardly be expected to allow sufficient time for this new approach to provide a satisfactory solution to their new problem. Constantly undermined by intellectual confusion, economic illiteracy, and national selfishness—and by personal rivalries among some of the protagonists—the experiment collapsed at the beginning of the 1930s. The collapse contributed in large measure to the horrors of that decade.

Some time later, an attempt was made to improve matters. The inconsistencies in the celebrated automatic mechanisms of the gold standard were recognized, and the Tripartite Agreement of 1936 sought to pick up the threads of international monetary organization and make provision for the active management that was so sorely needed. Unfortunately, the techniques for successfully putting such arrangements into operation had not yet been developed, and this new approach also failed. It imposed special responsibilities on the monetary authorities of the three major powers of that time—France (leader of the old "gold bloc"), the United Kingdom (leader of a sterling area declining in importance), and the United States—as well as on the monetary authorities of other parties to the agreement (Belgium, the Netherlands, and Switzerland). The obligations stemmed from the principle of symmetry, and experience was once again to show that symmetry, even subject to controls, is not an appropriate principle for international monetary organizations, since national currencies are not equals. We now know that the market had already gone beyond the ideas of those who negotiated this agreement, and that the monetary authorities had themselves joined forces with the private sector to make the dollar the true international currency by giving it functions that entailed special privileges.

Closer to our time, there was the Bretton Woods Agreement. What a strange edifice we have in the charter of the International Monetary Fund! The ideas of Keynes having been rejected, its theoretical basis was as obsolete in 1944 as were the ideas circulating in the corridors of central banks at the time of the Gold Delegation. The world had already been in the dollar era for some years, but the charter of the Fund ignored this fact and required—through its somewhat ambiguous convertibility regulations—a return to symmetry of rights and obligations. Once more the market, now encompassing the operations of many governments (including, at it turned out, those of the Communist countries), refused to respond to decrees, and the Bretton Woods system was never put into practice. At the beginning of 1959, the governments of the principal member nations ceased to take advantage of the transitional arrangements and accepted the "normal" regime as defined by the charter of the Fund. But within a few weeks at most, an "interpretation" of certain fundamental rules of the charter confirmed one of the major privileges that had accrued to the dollar, its supremacy as an intervention currency in the exchange markets, a supremacy the original documents certainly did not envisage. As a matter of course, the dollar had established its supremacy in other spheres as well; the market had imposed its decision in a manner too fundamental ever to be seriously questioned until the present moment.

The lesson to be drawn from this review of the past is clear. There is a noticeable gulf between the constraints and benefits that result from participation in the monetary arrangements dictated by the market and the legal rights and obligations that are supposedly established when monetary treaties are negotiated and ratified. This gulf has opened up several times in the last half-century, and now that the intention has once more been expressed to carry out a "reform of the international monetary system," we must ask ourselves what the chances of success are. Will the lesson of history be demonstrated once again or will ways be found to transcend it?

The idea of reforming the conduct of international monetary relations was launched about a decade and a half ago, if the story is taken back to Triffin's first recommendations during the early discussion of ways to disconnect the provision of international liquidity from deficits in the U.S. balance of payments. One of the first results was the decision in 1967 to create "Special Drawing Rights" (SDRs), which were to serve as a complementary reserve asset in the event of a closing of the American deficit—an outcome apparently desired by all parties, including those most closely involved. The decision of 1967 was given effect in 1970, but it did not have the anticipated effect; actual developments, in fact, increased the asymmetry attaching to the status of the dollar. Following the two key events of 1971, the suspension of dollar-gold convertibility on August 15 and the Smithsonian Agreement of December 18, the world lived under a "universal dollar standard" until it was plunged into the profound monetary disorder of 1973. As might be expected from the historical precedents, the authorities responsible for reform felt that their task had become a matter of pressing urgency. In the course of the Annual Meeting of the IMF in Nairobi in September 1973, a first Outline of Reform was presented by the Chairman of the Committee on Reform of the International Monetary System and Related Issues. In his introductory report he said:

> The general shape of the reformed system has been defined and significant progress has been made on some important issues. Arrangements for adjustment and convertibility are to be effective in avoiding the protracted imbalances which led to the breakdown of the Bretton Woods system: symmetrical in relation to all member countries, large or small, developed or developing, in surplus or in deficit; and consistent with each other and with the volume of global liquidity. The SDR is to become the principal reserve asset of the reformed system, with the role of gold and of reserve currencies being reduced . . . .

The text of the first Outline, which no official representative accepted in its entirety but which "in the opinion of the Chairman" expressed the progress of the Committee's discussions, conforms to precedent by echoing the traditional leitmotif. It insists on a symmetry of rights and obligations between currencies. But it is at the same time revolutionary, at least in appearance, in looking to a reform which would base international monetary relations on a fiduciary instrument created by international agreement rather than on *national* fiduciary instruments like the pound or the dollar. One may well ask what the effect can be of putting a revolutionary plan to the service of an ancient illusion—the illusion of symmetry—and what the chances are of carrying out that plan.

2 Understanding the Lesson of History

In their international relations and the treaties they draw up, the fundamental attitude of nations derives from an ancient tradition. The full exercise of sovereignty is defined by three essential functions: the administration of justice, the raising of armies, and the striking of the coinage. The tradition of national sovereignty is particularly strong in the monetary sphere, even though experience has shown that it has gradually lost its meaning for small and medium-sized nations, and that, in a world ever more characterized by the interpenetration of economies and the development of rapid communication, the tradition no longer corresponds to reality.

As long as national sovereignty was exercised over economies that were largely or almost completely self-sufficient, as was the case for centuries, national monetary action was monopolistic in nature. Even then, however, the monopoly was never complete. Although the state had the power—and often the exclusive power—to create legal tender, it could never enforce its use. Individuals and firms have always had a certain choice in the matter, at the cost of some inconvenience. The long-established response to growing inflationary pressure—and the most widespread response today—has been the flight from one national currency to another or to real assets (gold, land, property, antiques).

The state's monopoly in the monetary sphere was impaired more seriously in the nineteenth century with the first appearance of what is called the "international economy," that state of affairs in which an ever more important part of economic activity within the frontiers of a nation is dependent on transactions with the rest of the world. The first appearance of an international economy brought with it a need for an international money, and gold provided an early means of satisfying that need. But just as the goldsmiths of the medieval guilds, the bankers of Renaissance Italy, and the Hanseatic merchants of Germany, Holland, and Britain had invented financial instruments easier to handle than gold—promissory notes and bills of exchange—and just as gold was replaced by paper money within the frontiers of the established and new nations of the nineteenth century, a similar process was bound to emerge in international monetary relations, and for the same reasons.

Given a choice between the currency offered by the "local prince" and other monetary instruments, by what criteria was the choice to be made? One very old criterion, of course, was stability in value. At the outset of the modern economic era, another criterion, liquidity, became important, and this criterion is of greater interest in the present context. Thereafter, traders (and here, to a growing extent, we must include governments themselves, including, at a certain point, the Communist countries) were bound to choose the currency that would best satisfy these two criteria *simultaneously*.

The liquidity criterion corresponds to a fundamental economic objective—probably the most fundamental objective of all—the search for economies of scale. Moneys are like languages: if there is a choice among the media of communication (in the economic or intellectual spheres) that medium—money or language—will be chosen which enables the operator to do as much as possible without being forced into exchange dealings or translation.

The savings—or profit—produced by the opportunity to avoid exchange dealings can be realized in all sorts of ways. First, as has just been indicated, traders dealing with the foreign sector of an economy incur expenses by continually switching from one foreign currency to another or from foreign to domestic currency. Gold by its very nature cannot meet these requirements, and so an "international money" is "elected." The market will "vote" for an international money by using or holding it in preference to other moneys. In this way, it will minimize exchange dealings. The currency elected will be one in which a very large number of transactions are settled or one that has certain prerogatives that make it attractive to the foreign sectors of other national economies.

The smaller a country with a high per capita income, the larger the influence of the foreign sector on its overall economy; furthermore, in the modern industrial world there is a tendency for foreign sectors to show more or less continuous growth. If we look only at current transactions, the foreign sectors of the Belgian and Dutch economies represent nearly 50 per cent of GNP; between 15 and 25 per cent of the GNP of France, Britain, and Germany; and about 6 per cent of the GNP of the United States (which is on the order of $1,200 billion, eight or nine times the GNP of France).

But traders are not simply concerned to minimize costs. The relative ability of financial centers to provide investment opportunities for the balances held in their national currencies is also important to the choice of an international currency. The center that wins out will be the one that gives holders of currencies the widest range of investment opportunities, the highest degree of liquidity in its investment instruments, and the greatest stability in the value of its currency.

It is an oversimplification to believe that all these considerations influence only the private sector, and mainly the banks. Governments face some of the same constraints to which private traders are subject when they choose an international currency in which to hold reserves or choose a reserve asset, such as gold, with a view to preserving their autonomy. The failure to recognize this similarity between the situations of private and official actors derives from a failure to understand the way modern economies work; it is also a source of ambiguity and even of misunderstanding with regard to the notion of autonomy or national sovereignty.

Consider first the role of the government or, more strictly, its "monetary authorities" (the Treasury and the central bank). These institutions are important in two ways. First, the recent but continually growing intervention of the government as an economic agent that cannot ignore economies of scale gives it an interest in minimizing conversion costs and in the availability of liquid and high-yielding investments. Second, the more traditional role of the government as the holder of national monetary reserves has even more important consequences, since this is the mechanism through which monetary constraints originating in the foreign sector have their domestic effects. There is no way for the government to avoid this role, for two reasons: (a) It must foresee, and to some extent prevent, harmful effects on national economic welfare from more or less transient disturbances in the foreign account—disturbances caused by strikes, the business cycle, erratic price and supply movements, etc. (b) It must provide a service by holding a substantial stock of foreign currencies for delivery to private individuals and firms that, for various reasons, do not wish to hold these reserves themselves. The supply of and demand for foreign currencies by the private sector are subject to offsetting fluctations to some extent, and there is a net gain to the national economy from the readiness of the monetary authorities to hold reserves, so that individuals and firms need not hold liquid assets in foreign currency but can instead put their resources to more profitable uses.

Now consider the power of individuals and firms to choose the currency in which they keep accounts, make settlements, and hold reserves. The error is to assume that they will choose—or can be compelled to choose—the domestic currency. Their horizons are becoming less and less "national." To stress the risk of error in this assumption, it is sufficient to note that the "foreign" production facilities of all multinational companies were responsible for an output of goods and services of approximately $700 billion in the mid-1960s (i.e., about 40 per cent of the total output of the non-Communist world) or to refer to the considerable problems presented by the operations of multinational companies. When one reads in the report of the Finance Committee of the U.S. Congress for February 1973 that the liquid assets which could be shifted across frontiers were estimated at $268 billion, or when the executives of big American firms in Paris, London, Buenos Aires, or Singapore instinctively speak of the U.S. dollar as being the "home currency of the company," one feels a very long way from the dictum that "only the prince can strike coinage."

The elucidation of the lesson of history cannot be complete until we have cleared up an old ambiguity. In defense of certain monetary systems—for example, those based on gold—it has often been claimed that it is a matter of protecting a nation's monetary "independence" or "sovereignty." Whether deliberate or not, there is a confusion here between two very different things—on the one hand, independence, which, properly defined, is the capacity to act with relative freedom from restraint, and, on the other, the desire to restrain the country or countries whose currencies have become international from exercising the consequent privileges. This second objective is likewise expressed in the search for a symmetry of rights and obligations; to realize this is to see very clearly the essentially political nature of that search. When one looks at certain episodes in the monetary history of recent years, one is tempted to use the language of Clausewitz and say that "money—or gold—can also be the pursuit of diplomacy by other means."

As for national independence in the economic sphere, it must be remembered that when the gold standard was in full force the whole world formed something like a monetary union; in other words, national independence in monetary policy was weak or nonexistent. And the most generally accepted reason for our inability to return to a system based on gold is precisely the narrowness of the constraints it would impose on national economic policies. I shall argue later that nations participating in a system dominated by a single national currency are likewise considerably restricted in their economic policies. The difference between the two situations is that under a gold standard it is the system as a whole that is subject to the constraint (the danger of insufficient liquidity), insofar as the price of monetary gold does not change, whereas, under a system based on a national currency playing an international role, the degree of liquidity of the system depends on the propensity of the reserve-issuing country to maintain a deficit in its balance of payments. Experience so far has been that this propensity is large and the lack of independence of the other countries under the system is a function of their relationship with the reserve-issuing country and of their passivity toward economic impulses originating there.

Another confusion that ought to be cleared up is created by the proponents of national independence when they take issue with the Keynesian tradition. It is helpful to distinguish between two aspects of the work of Keynes. On the level of ideas—on the scientific level, if one may use that word when talking of economics—Keynes was the principal initiator of a revolution in our way of looking at economic phenomena in general and monetary questions in particular. On the level of action, on the other hand, he made a major contribution to the alleviation of the distress of his time and country by revising accepted notions of economic policy and by his original insights into the scope for government intervention in the economic process. This is just what the "liberals" resent, whether they are the vanishing votaries of gold or whether they call themselves "monetarists." But Keynes, the principal modern critic of the gold standard, was certainly aware of the constraints that can beset an economy as a result of the international monetary system. That is why he did not limit himself to certain recipes for full employment that depended on domestic political action, but went on to describe the external arrangements that would be necessary to the success of the policies he suggested. One of Keynes's recommendations was to break as completely as possible the link between the domestic economy and the rest of the world, and this led him to reestablish a place in economic policy for an instrument long spurned because of the predominance of the classical tradition—floating exchange rates. There was someone else at the time who emphasized that instrument, and with it barter agreements and exchange controls, and that was Dr. Schacht, Governor of the German central bank at the time of Hitler.

Given the general situation at the time and the priorities held by Keynes, it is difficult to dispute the consistency of his recommendations. But some of his methods, and even more those of Schacht, have become outmoded. The world has shrunk since the time of Keynes (development of communications); economic perceptions have changed (money illusion, an essential condition for success in devaluing currencies, is tending to disappear); the economic problems that have afflicted the world since 1945 have been quite different from those of the prewar era (inflation has become the scourge); and, finally, the policy instruments that can be used to break free from or reduce the dominance of an international currency have lost their effectiveness (in the case of exchange control) or are somewhat discredited (floating exchange rates) because they are liable to abuse or are alleged to be ineffective and harmful to welfare, particularly when applied between highly interdependent small or medium-sized economies. Something else is required to meet the needs of the modern world.

The treaty establishing the European Economic Community derives essentially from the realization that the countries of Western Europe are no longer large enough for the economic welfare of their populations. The treaty seeks to go beyond the nation-state as the fundamental unit of production and trade. The officials who negotiated it in 1958 did not know how far this process had already gone in the realm of monetary policy. Thus, outdated techniques were preserved in the monetary sphere at a time when the last traces of the principle of symmetry (the illusion of the equality of currencies) were disappearing and when events had already shown that the market's choice of an international currency could cause grave damage if that currency itself became the victim of economic disorder.

3 Projecting the Lesson of History

The concept of a "system" has been much misused in the literature on "international monetary systems." This is probably a legacy of the eighteenth century and the thought of David Hume, to whom we owe the most famous exposition of the functioning of the gold standard. At that time, of course, the "currency" used within national frontiers was the same as that used for external settlements, so that the gold standard was sufficiently "pure" to make it possible to talk of a "monetary system" without departing too far from reality. Long after its disappearance, this appealing mechanism left a nostalgia for automatic stabilizers and established the idea of a system in the minds of those who have tried to describe what has for very many decades been a mixture of more or less disparate elements. For since the demise of the pure gold standard, international monetary relationships have become too heterogeneous to justify being called a "system."

Since about 1900, these relationships have been made up of dominant and recessive elements. Between 1900 and 1914, gold was clearly a recessive element and the pound a dominant element in the foreign trade of the United Kingdom. There is reason to believe that the franc and the mark were in a similar position to gold. After World War I, the international role of these two currencies shrank or disappeared and that of the pound triumphed. Sterling in turn lost ground, and by 1931 gold became dominant once more in trade between the gold-bloc countries. Toward the end of the 1930s, the decline of both gold and the pound was well under way, and the dollar was entering its era of dominance, which was to develop so spectacularly between the end of World War II and the late 1960s. It should be emphasized that at no time did one standard or numeraire have a complete monopoly in international trade, but only a greater or smaller predominance over others.

The evolution of the role of the dollar during the last decade derives from two sorts of phenomenon, the first cyclical in nature, the second structural. In connection with the cyclical factors, it has been known for some time that the size of the American economy combined with the dominant international role of the dollar have an enormous effect on the world economy, and no country with an open economy can hope to escape it. If the United States has an inflationary boom, the rest of the world is forced to accept an inflow of funds either directly or through the Eurodollar market. Added to the real effects of American demand, this inflow has a worldwide inflationary impact. The level of international liquidity, both private and public, is determined by the supply of dollars resulting from the U.S. balance-of-payments deficit, which in turn corresponds more or less to the relative rate of inflation in that country. The rest of the world absorbs this supply either because individuals and firms need more liquidity as a result of the boom in the United States, or, if private demand does not grow quickly enough, because the monetary authorities intervene in the foreign-exchange markets in accordance with the rules and agreements relating to the exchange-rate system.

The United States is a country where orthodox tradition in the field of economic policy is still relatively strong. There is more scope for countercyclical policy there than in other countries because the size of the U.S. economy protects it from external forces. Over the last forty or fifty years, the dollar has been, on the average, the world's most stable currency. Periods of inflation have been, and still are, shorter and less intense in the United States than elsewhere. The important thing is that the United States controls the world trade cycle. Whenever the United States decides to "put an end to the boom" and get back on the road to stability, the resort to stricter budgetary, and especially monetary, policy acts either directly or through the Eurodollar market like a suction pump on world liquidity. The level of international liquidity is then determined by the rest of the world's demand for dollars. This demand has recently tended to adapt to greater liquidity. Fearing a shortage of reserves, the rest of the world demanded more liquidity from the United States (directly or through the Eurodollar market). The tendency toward a cumulative surplus in the current balance vis-à-vis the United States and capital imports of all kinds, including direct foreign investment by the United States and borrowing, made a deficit in the U.S. balance of payments inevitable. From the beginning of the 1950s, the United States was in continuous deficit in every year except 1957, the year of the Suez crisis.

Over the last decade, business fluctuations in the United States have become larger. Between 1965 and 1969, the inflationary boom in the United States caused by the growth in demand associated with the Vietnamese War (which was financed by the creation of money rather than by taxation) transmitted strong inflationary impulses to the rest of the world. In this period, the United States registered a growing international deficit resulting from a huge net outflow of capital and a rapidly declining surplus on current account. The arrival of the Nixon administration marked the start of a policy of cutbacks in demand, and the "suction pump" effects of the restrictive monetary policy of the Federal Reserve Board produced spectacular rises in interest rates throughout the world. The European countries, individually and as a group, made strong attempts to persuade the American authorities to moderate their monetary policy. So short is the memory of both observers and officials that there is no recollection now of what happened in a period as recent as the years 1969 and 1970.

Scarcely was President Nixon halfway through his first term when the administration, which had been elected in November 1968, felt it a matter of pressing necessity to make sure it got a second term. With breathtaking cynicism, President Nixon—that paragon of Republican and conservative virtues—declared, "I too am a Keynesian" and embarked on an expansionary policy which had an enormous effect on foreign account. Not only did the U.S. current account deteriorate spectacularly but, in addition, there was large-scale speculation; for the first time since the 1930s, the international supply of dollars passed the saturation point. Private holders of dollars attempted to unload their balances, selling them in massive quantities on the foreign-exchange markets. The central banks stuck to the rules of the game for a while and bought up the excess supply of dollars. But some of them, fearing a repetition of their experience when sterling was devalued in 1932, demanded that these dollars be converted into gold. If the United States honored the commitment it had made to dollar-gold convertibility in Article 4 of the IMF Charter, however, it risked precipitating an avalanche. For some time the gold assets of the United States had been insufficient to guarantee the convertibility of dollar liabilities to foreign monetary authorities. Toward the middle of 1971, the gold assets of the United States were of the order of $10 billion, while its liabilities to foreign monetary authorities were some $34 billion and to nonresident private holders some $19 billion. On August 15, 1971, President Nixon announced that the United States would no longer honor the obligation to convert dollars into gold. Thereafter, U.S. liabilities grew even more rapidly, reaching $90 billion before the monetary authorities of most industrialized countries decided toward the end of March 1973 to suspend intervention in dollars on the foreign-exchange markets. There followed a general floating of exchange rates, a period in which we still find ourselves. But the pendulum has already begun to swing back. Inflationary pressures have abated much more in the United States than in most other countries; the U.S. balance of payments has greatly improved as a result of the present undervaluation of the dollar and the change in the world payments outlook resulting from the huge rise in oil prices. The dollar is on its way toward becoming a strong currency again.

While cyclical swings were accelerating, the second phenomenon affecting the status of the dollar—a structural change—was becoming evident. A few figures can be quoted to show the nature of this change. In 1945 the output of the United States was approximately equal to the total output of all other countries in the world. In 1960 the GNP of the United States was only 40 per cent of the total of GNPs of other countries. By 1972 this percentage had fallen to 33 per cent. According to some projections, it will be only about 25 per cent in 1980. A complementary development has occurred in various industrialized areas of the world, particularly Europe, and in certain countries in particular, such as Japan and Germany. There can be no doubt that a relative decline has occurred in the economic importance of the United States.

This fact has two important consequences. First, world demand for dollars as a means of commercial settlement and as a store of value has suffered a relative decline that will tend to continue. Conversely, assuming a projection of the trend of the last twenty years, a growing demand for the currencies of other industrialized countries (especially the franc, the mark, and the yen) is to be expected. Second, the relative decline in the economic power of the United States leaves it much less scope than it had in the past to manipulate the international monetary mechanism so as to secure the privileges of the dollar and limit the usual effects on a reserve-issuing country arising from the unstable behavior of the private sector.

The American authorities did nothing in the 1930s to encourage the market to make the dollar *the* international currency, and thereafter American representatives sometimes even resisted this development. But at some point the United States authorities changed their attitude. From about 1965 on, their traditional hostility toward the sterling system, amply demonstrated in the immediate postwar years, was transformed into a cooperative stance. This cooperation increased as it became evident that there were similarities in the effects of reserve-issuing status on the British and American economies. The situation provoked the somewhat exaggerated remark of a Secretary of the Treasury that sterling stood in the front line of the dollar's defenses.

Is the era of the dollar at an end and is the era of other currencies, such as the mark or the yen, beginning? The question has often been asked since the dollar began to show weakness. To appreciate its meaning, first consider our analysis of the factors involved in choosing and keeping a currency as an international reserve asset. The currency chosen must satisfy much better than other currencies the criteria of both liquidity and stability. Of course, the mark and the yen can show greater stability than the dollar over the short term. But what conclusions would be drawn from a comparison extending over two, three, or five decades? How many countries can show greater stability than the United States in their currency (and in their political institutions) over a long period? One has only to ask this question to place in perspective the possibility of competition between the dollar, on the one hand, and the mark or the yen on the other. The same conclusion emerges if one takes the criterion of liquidity, that is, the size of the public willing to accept a currency for the settlement of commercial transactions and the denomination of investments.

There could hardly be a more striking illustration of the acceptability of the dollar than that provided by *Le Monde* on December 30, 1972. At that time, European financial commentators tended to see in the dollar crisis the beginning of the end for the dollar's international role. But in his less exalted columns, the writer of the "Holidays and Leisure" page saw things more clearly when, under the heading "Currency," he recommended that people going on a 22-day round-the-world trip "equip themselves with just one currency for all the countries visited, including Tahiti—the U.S. dollar in small-denomination notes or travelers' checks."

Given the status of the source, more authority will attach to the opinion expressed in an article in the *Bulletin* of the National Bank of Belgium in October 1973. It analyzed in the following terms the changes in the Community exchange system since the suspension of intervention in dollars in March 1972:

> The abandonment of fixed margins of fluctuation against the dollar has had no effect on the use of that currency by foreign-exchange dealers as the unit in which they quote their rates. The use of a common reference unit, which provides the basis for calculating all cross-rates, assists the dealers greatly in their work. Because the number of dollar deals is so large and because the dollar money market is so broad and flexible, that currency continues to have advantages over all others as a unit in which to express rates of exchange.

Of even greater importance is the fact that the dollar has never had a serious rival—whether another currency, the SDR, the unit of account, or a similar instrument—in another function whose importance is little understood. This is the role of transmitting information when comparisons must be made in monetary terms. Just as the American communications satellite, Telstar, was the link that had to be used by anyone wanting to receive live pictures of the Sapporo Olympics, so the dollar is the inevitable medium for communicating data about financial magnitudes that are of interest to more than one country.

It is symptomatic that Jacques Rueff, in the books and articles in which he extols the virtues of the gold standard, cannot avoid implicitly honoring the dollar by invariably quoting figures in dollar terms. A weight of gold would be meaningless to Rueff's readers as the measure of a deficit he wants to discuss, or of a Marshall Plan type of loan to be made to the United States. He acknowledged this in the last series of articles he published in *Le Monde* on May 15, 16, 17, 1973, under the heading "Prolegomena to Any Reform of the International Monetary System." Rueff makes a more realistic choice—doubtless without realizing how much he is giving away—than is made in statistical sources such as the IMF's *International Financial Statistics*, in which some important figures (exchange rates, reserve levels, etc.) are expressed in terms of SDRs. Even this publication, after having indicated that, at a certain date, a franc is 0.16 grams of gold and there are 5.555419 francs in an SDR, adds that 4.6 francs represent $1. You can bet that only a very small minority take an interest in the first two figures!

If we look beyond the short-term horizon of the business cycle and set aside for the moment some of the recent ideas for reforming international monetary relations, the following conclusions emerge. The flexibility and dynamism of the American economy are still large; even at a time of serious tensions in national political institutions, the government has a concern for economic stability which gives some guarantee of the long-term value of the dollar that the market cannot ignore. The breadth and variety of New York's financial markets will tend to preserve its supremacy and could well be enhanced by the removal of controls on capital exports.

The combined effect of these factors seems likely to compensate to some extent for the relative decline in importance of the American economy—particularly since the effects of the decline will be overestimated unless the weight of multinational companies that are effectively controlled from the United States is added to the American side of the balance.

This does not mean that other currencies will not share certain international functions with the dollar; indeed, this possibility has already been mentioned. The decline of one of the key currencies—the pound sterling—has continued for half a century. The growth of sterling balances over the last few years should cause no illusions. It is only partly the result of free choice by the market and more the result of measures taken to protect a weakened economy from harmful pressures on its currency. The pound's reserve functions have been preserved mainly by a system that combines an exchange guarantee vis-à-vis the dollar with higher interest rates than are available in New York. On the other hand, two other currencies have benefited from the market's continual search for ways to meet its requirements. They are the yen and the mark. The rise to international prominence of these two currencies is still obscured by various factors, including one which is common to both countries involved. Since the end of the war, they have both felt the greatest hesitation about anything resembling a "forward" policy in foreign affairs, and this hesitation has led them to discourage by all the means at their disposal any foreign buildup of balances in their currencies.

The Japanese authorities have much more scope for effective intervention than the Germans and have therefore had far greater success so far in adhering to this cautious approach. But their caution has weakened before the economic and monetary forces at work in Japan and the opportunities that have existed for some time. Analyses by important Japanese economic research institutes suggest that, in response to its entanglements with a Western world that has already delivered several "schockus," as they say over there, and that is fearful of powerful Japanese competition, Japan could well abandon its caution in the next few years, allowing free play to trends hitherto suppressed and even giving them a boost. If this happens, a "Japanese monetary zone" based on the yen could appear as a proper complement to and support for the consolidation and even the expansion of a "Japanese economic zone." The oil crisis could perhaps provoke the formation of such an economic zone by increasing interdependence between the center and the peripheral areas.

Developments affecting the mark have in some respects gone further than those affecting the yen, and they give a perfect illustration of the process by which a national currency is chosen as an international instrument. Not only have the German authorities done nothing to encourage these developments, but they have tried to stop them by every possible means, whether or not these means were compatible with their hatred of restrictions and controls. The extent of their failure is revealed by a calculation appearing in the 1973 official report of the activities of the central bank of the Federal Republic of Germany, showing that even now the mark is used more extensively than sterling in official reserves. A precise figure is available for holdings of sterling balances, approximately $15 billion. Figures available for mark balances are much less exact because the important component here is not the deposits in German banks but those in "Eurobanks," which are less easily estimated. The margin of error is not, however, so great as to prevent the German authorities from knowing the approximate magnitude involved. Such figures are not the only indicators of the mark's progress toward international status. Every banker engaged in international operations knows how rapidly the demand for marks has grown in recent years as a means of settlement and a medium of investment and how its use in invoicing has expanded. Finally, the development of international payments relations within Europe (for example, the informal participation in the "snake" arrangements by European countries that do not belong to the EEC, such as Norway and Sweden and, to some extent, Austria and Switzerland, for whom trade with Germany is of prime importance, along with the Netherlands, Denmark, and Belgium) has led various commentators to ponder the consequences of the increasing economic and monetary weight of Germany, should European monetary arrangements continue to fail to assume a truly Community character.

To this general picture of the roles of national currencies at the present stage of international monetary relations must be added a completely new factor, Special Drawing Rights. Established under the auspices of the IMF in 1970, the future of the SDR is now tied up with the reform of the international monetary system. Furthermore, Europe has the task of giving a more active role to the European unit of account, which initiates call the "Europa." It is important to know how much the establishment of these instruments will tend to modify the picture that has just been drawn.

4 Going Beyond the Lesson of History

The world has been looking for an international currency ever since the emergence of an international economy in the nineteenth century. We know from experience that it is impossible to find a currency that satisfies all the conflicting requirements of the interested parties, and reflection suggests that only a fundamental change in the relations between nations can provide a solution to the problem.

As we have seen, gold used to meet the political requirements of governments (although the fact that the principal producers of gold are South Africa and Russia makes it doubtful that gold is as politically neutral as some have claimed), but it has ceased to be adequate to today's economic, monetary, and technical requirements. It was the political requirements which had to give way to the others. Furthermore, governments have been content to give an apparent legal validity to treaties and agreements affirming the equality of rights and obligations, but at the same time they have come to terms with the reality of international monetary life, where for half a century now the fundamental characteristic has been an asymmetry associated with the use of reserve currencies.

The divorce between legal appearance and economic and technical reality is most apparent in the separation of the international functions that the monetary instruments are expected to perform. When the gold standard was in force, gold performed the three essential functions of an international money for both the monetary authorities and, to a lesser extent, the private sector. It served as a standard of measurement or unit of account (the numeraire in the Walrasian sense), an instrument for the settlement of debts (and for central-bank intervention), and a reserve asset.

The international monetary mechanisms devised over the last half-century have continued to ascribe the first of these functions to gold, but in practice even this function, and to a greater degree the other two functions, were discharged by reserve currencies, first by the pound sterling and later by the dollar. We have already examined the market forces by which a national currency was selected for international use, generally the currency issued by the greatest economic power. The result was a number of asymmetries, the most important of which must be discussed here.

The best known—because it is the most frequently criticized—is the freedom of the country issuing the reserve currency from the *adjustment constraint* (in our inflationary era, from the need to restrict demand when the country has a balance-of-payments deficit). This privilege is directly connected with the dispensation given that country—whatever the formal provisions of international agreements—from the *convertibility constraint* (the requirement that it convert its currency into instruments which it cannot create on its initiative alone).

These two asymmetries are the result of a phenomenon that is generally disregarded because it is usually dealt with in forbiddingly technical literature. But this phenomenon is fundamental, occurring as it does at the intersection of two planes of international monetary relations—those of the private sector and those of the monetary authorities. This phenomenon is *intervention*, the mechanism by which monetary authorities keep fluctuations in exchange rates within agreed limits by means of sales or purchases of foreign currencies on the open market.

To date, intervention on the exchange markets has taken place in four ways:

a. Selection of one currency (the dollar) or several key currencies (if we are thinking in terms of "monetary areas") as a common denominator in which each country's monetary authorities will intervene on their own exchange market, relying on private arbitrage to assure the consistency of cross rates;
b. Use of a "neutral currency," such as gold;
c. Official purchases and sales at fixed prices of whatever currencies are required or offered by transactors;
d. Intervention in each of the currencies traded on the market in which

the central bank intervenes—what the technicians call the "multiple-currency intervention system."

It has already been shown that method b, intervention in gold, is no longer possible. Method c was used in the original form of the European Payments Union, when there was strict exchange control, but was later rejected in favor of a more effective market mechanism, because with method c monetary authorities could not prevent "diversions of exchange transactions." (Agreement between official institutions to carry out exchange transactions between two currencies at a certain price cannot be forced upon reluctant private operators, especially on "third" markets.)

We are left with methods a and d. Even a superficial comparison shows the technical advantages of method a. If n currencies are traded on the exchange markets, arithmetic tells us that with method d central banks must be involved in $n(n-1)/2$ relationships among themselves, and detailed rules must be worked out to regulate those relationships. With method a, intervention implies only $n - 1$ relationships among central banks, and intervention can proceed without a great deal of consultation. Through arbitrage, market forces assure the consistency of the system *as long as the monetary authorities who are issuers of the* nth *currency refrain from intervention themselves.* This is the method that has been used on an international scale since the reintroduction of convertibility in 1958. Once a national currency has acquired international functions by the process described above, it is logical for that currency to serve as the numeraire and instrument for intervention. That is how the dollar came to serve as the intervention currency on all the main foreign-exchange markets and how the various related asymmetries arose. *The most important asymmetry consists of the ability—indeed the obligation—of the authority issuing the key currency to refrain from intervention on its own foreign-exchange market.* As a result of this and related asymmetries, the American authorities were able for a long period to take no interest in events on the foreign-exchange markets and, strictly speaking, to have no exchange-rate policy. Therein lay a great advantage for the American authorities; the political and economic superiority of the United States enabled it to dominate the workings of the system, and its domestic economic policy did not come into conflict with considerations of foreign economic policy.

As we saw in section 3, this situation has changed in recent years and the U.S. authorities have been led to consider some modifications in a system that was no longer working the way they expected. Their partners were finding it hard to decide whether to accept the implications of the adjustment process by revaluing their currencies or to go on absorbing an increasingly unwelcome inflow of dollars swollen by inflationary financing of the Vietnamese War and amplified gigantically by speculative forces. It has often been said that the crises in the foreign-exchange markets in 1971, 1972, and 1973 were substitutes for negotiation. The outcome of these disorders was an indication by the United States that it no longer wished to play the role of the n^{th} country, at least on the institutional terms set out above. Two issues emerged which became the core of the negotiations on the reform of the international monetary system, on which a tentative conclusion was reached in the Nairobi proposals. On the one hand, the industrialized partners of the United States, principally the European countries, saw in the U.S. shift an opportunity to gain acceptance for a system of strict convertibility, under which the United States would no longer be able to finance deficits in its balance of payments by an excessive creation of its own currency. On the other hand, the United States wished to build a larger degree of automaticity into the mechanism that would trigger the adjustment process, reckoning that the discipline of such a system would mainly affect European countries with a mercantilist tradition. The arguments of the two sides represented a dialectic between two views of symmetry—a dialectic that can be detected in all the clauses of the Nairobi proposals. The dialectic recurs, as we shall see, in a recent New York address by Jeremy Morse, Chairman of the Deputies of the Committee of Ministers (Committee of Twenty), before the National Council for Foreign Trade. A close reading of that text reveals that, although the asymmetries described above may have been recognized and their causes identified, the Committee of Twenty has nevertheless been unable to agree finally on how to prevent their reappearance in the future.

Three solutions are possible:

a. The institutional approach, as represented by the Nairobi proposals for a "reinforced monetary fund" (paragraph 1). However, the same text refers only to "new procedures, involving special meetings, at regular intervals, of a Fund consultative body at an appropriate level" (paragraph 4). Furthermore, in his New York speech, Morse takes a very reserved attitude, saying that "in general the choice among different forms of policy action for maintaining or restoring external balance is to be left to the discretion of the country concerned" and that "the Fund would have no express power to insist that a country should adopt a particular form of adjustment policy." The evidence suggests that we are not going to get changes in the institutions that will enable them, by their own authority, to establish and preserve a symmetry of rights and obligations.

b. The planning approach, under which an attempt would be made to foresee any danger of disturbance and meet it with automatic, or at least prearranged, remedies that preserved the principle of symmetry. The Nairobi proposals outline such an approach, but so vaguely and with so many reservations that no immediate commitment can be inferred. It would appear from Morse's speech that the important differences of opinion detectable in the proposals have not yet been resolved. Morse is very explicit:

> . . . There is always a danger in a negotiation that you will put together a compromise rather than a construction. At least I can say that so far that danger has not been ignored in the negotiation. One of the objectives of the reform listed in paragraph 1 of the Nairobi Outline is consistency between arrangements for adjustment, convertibility and global liquidity. If the supply of liquidity is inadequate, the system will break down. . . . Equally, if the supply of liquidity is excessive, the system will become inoperative in a different way. . . . If, however, the supply of liquidity is in the right range, then a symmetrical system demands . . . some consistency between the arrangements for adjustment and for convertibility. For plainly a rigorous adjustment system combined with loose arrangements for convertibility tends to put the burden of adjustment on countries in surplus; and conversely loose adjustment combined with rigorous convertibility puts the burden on countries in deficit. . . . The inclination in the Committee of 20 has been to err on the side of tightness rather than looseness, so as to avoid the repetition of past errors.

But Morse does not tell us specifically how to establish such a system and seems to doubt whether it would ever work. He warns ". . . we must recognize the danger that a system of this sort might in fact prove to be overmanaged. Overmanagement tends to misguided management, and that is generally worse than no management at all."

c. A third approach, which appears in the literature, taking as its starting point a feature of the textbook gold standard. Here gold was the n^{th} currency, but it was an "international" currency that could fulfill the intervention role in a completely neutral way (that is, without impairing the symmetry of international monetary relations) and was therefore neutral, at least in principle, in all other respects discussed above (adjustment, convertibility, etc.). This approach says that, given the impossibility of returning to the gold standard, we must *create* a new n^{th} currency, an international currency that would make symmetry possible. There is nothing in the Nairobi proposals or in other official sources suggesting that international monetary reform will take this approach, and the signs are that, given the present state of international relations, there would be little point in recommending it. On close examination, it would even appear that the Nairobi proposals oppose this approach. When they deal with *intervention*, the role in which an international currency could contribute most to the establishment of symmetry, they suggest, albeit with some hesitation, that another route be tried: "A detailed examination will be made of the practicality and desirability of establishing a system of multicurrency intervention. . . . The object of such a system would be to promote greater symmetry among participating countries. . ." (paragraph 15). The route is the one which requires central banks to be involved in $n(n-1)/2$ types of intervention and in settlement arrangements so complex as to call to mind Morse's fears of an "overmanaged" system.

This interpretation is further confirmed by the sharp distinction in the proposals between the discussion of the problems of managing the foreign-exchange market, primarily by intervention, and the discussion of Special Drawing Rights. Paragraph 25 states that the SDR "will become the principal reserve asset and the role of gold and reserve currencies will be reduced. The SDR will also be the numeraire in terms of which par values will be expressed." In other words, the SDR is given a role quite different from that of an international currency.

The function of "expressing par values" is secondary. In the Bretton Woods system, par values were expressed as a weight of gold that was never changed and whose relation to the "value" of currencies became completely abstract. Thus gold served as a numeraire in the Walrasian sense—an accounting concept—and one could do without it. What matters is the value of a currency in relation to others and the verdict of the marketplace. As was shown in sections 2 and 3, experience has clearly demonstrated the power of the market in selecting one currency rather than another as the international money in which these values are most meaningfully expressed. Gold was the legal numeraire of the Bretton Woods system, but the market and the authorities conspired to make the dollar the true standard of value—the currency used for intervention, for commercial settlements, and for holding reserves. If this precedent has any force, the legal numeraire of a reformed system might be the SDR, but the market and the authorities alike would end up paying no attention at all to this accounting oddity. They would use something else as the true standard of value.

Furthermore, a good deal of experience with the simultaneous use of various "units of account" tied to specific functions prompts skepticism concerning some of the suggestions about the SDR in the Nairobi proposals. First of all, such units have never lived up to the hope that they would play a more or less privileged role in private dealings.

Second, their use in intergovernmental relations created certain illusions, but these lasted only as long as the confusion on which they were based —an invalid comparison to the dollar. When the confusion vanished, the fact had to be faced that units of account which did not have a firm connection to the international currency chosen by the market were bound to lose their "moneyness."

In this respect, nothing has been more misleading than the history of SDRs themselves. They were established in January 1970, after a gestation period of several years during which the idea became generally accepted, starting with acceptance of Triffin's proposals, that a reserve asset should be created that would supplement rather than replace existing reserves in currency or gold. Yet, from January 1970 to January 1973, only the equivalent of about $9.5 billion were created, and then the allocation procedure was suspended. During those three years the world had absorbed some $44 billion of dollar reserves, roughly equivalent to the cumulative deficit of the United States calculated on the basis of the liquidity it created in order to settle its liabilities to foreign creditors. The world did not want or need additional SDRs. Whether or not this attitude persists will depend on the economic performance of the U.S. authorities and their ability to maintain a reasonably stable dollar, rather than on the success of reformers in devising a method for evaluating the SDR and determining the rate of interest it will carry. As long as the SDR does not become a "real" currency, its artificiality will place it at a disadvantage relative to the dollar.

Throughout this period of reform, experts, academics, and officials alike had underestimated both the intensity and the generalized nature of the need for an international currency, just as they underestimated the capacity of the dollar to respond to that need, as it has done in the past in spite of its weakness as a result of the policies followed in the United States. It may well be that the authors of the Nairobi proposals, thrown off balance by the March 1973 storm that destroyed the system of intervention in dollars, have seriously underestimated this capacity for the future.

5 Conclusions

A study of the available documents dealing with the reform of the international monetary system suggests that the chances are not great that in the foreseeable future we will get beyond the lesson of history as identified and analyzed in this essay. The attitude toward the search for symmetry that can be inferred from the Nairobi proposals appears to be strictly in line with historical precedent. What course can the actual development of international monetary relations now be expected to take?

It was eminently reasonable for people attached to the idea of a united Europe to hope that it would be possible to break free from historical precedents by beginning to build an economic and monetary union in accordance with the objectives expressed by the highest authorities in 1969 and confirmed many times since then. Such an attitude could well have been given urgency by the fear aroused during the series of monetary crises that all the positive achievement of the Community would be undermined. Early in 1973, Jean Denizet, a distinguished French expert, declared in a paper for the EEC Commission's Study Group that "the future of the Community hangs on the existence of a common currency. Without it the Community will die, and die very quickly." His colleagues, including some of the best European economists, surely agreed with him on the urgency of the situation when they recommended the immediate creation of such a common currency (see the EEC report, *European Economic Integration and Monetary Unification*, Brussels, October 1973). Perhaps the outlines of a reform of international monetary arrangements is beginning to emerge, if not very precisely in the official documents, then at least in the work of a growing number of academics. The essence of the new approach is to place less emphasis on the worldwide rules hitherto characteristic of international monetary proposals and to allow for the existence of several multinational monetary zones linked to each other by mechanisms set up within a reformed International Monetary Fund.

Given such an approach, Europe could have been the first grouping to take on the cohesion necessary for participation as an entity in international monetary dealings. But here again the authorities felt that the time had not come to go beyond the lesson of history. Thus none of the three approaches identified in section 4 as possible paths to a solution of international monetary problems (the possible approaches are the same for European monetary problems) has yet been adopted by the authorities. While realism tinged with resignation makes it easy to understand why the "institutional approach" is ruled out at present, and while the "planning approach" seems bound to involve the risk of overmanagement in the European context, as Morse feared it would in the international context, it is harder to understand why, as an experiment, a common European currency should not be allowed to show what it can contribute. Analyses of this subject—and some excellent ones have been presented to the Study Group referred to above—suggest that the constraints imposed on national monetary policy by any such scheme would be no more severe than those imposed by the predominance of the dollar. The most serious question posed by any such scheme is quite different; it is whether a common European currency would have any chance of gaining acceptance, even in relations between European countries, in competition with a reinvigorated dollar. The answer to that question would depend above all on the readiness of member nations not simply to conduct the experiment but to promote its success.

Such, then, are the prospects for reform at the end of 1973. There seems for the moment to be no possibility of going beyond the lesson of history. As one must have hope, nevertheless, that an end will be put to the present monetary disorder, what course is the outcome likely to take? The spectacular improvement in the U.S. balance of payments and the renewed strength of the dollar recall the historical perspective of section 3, and the more or less regular fluctuations of the postwar world lead to the conclusion that, unless there are innovations, the dollar will again dominate international monetary relations, after what will probably prove to be a short period of instability.

POSTSCRIPT

This essay had already been sent to the printer in its French version and was being translated with a view to its publication in English when two developments took place that are closely connected with its theme.

One was the meeting in Rome on January 17-18, 1974, of the Committee of Twenty on the Reform of the International Monetary System. The communiqué issued at the end of this meeting (*IMF Survey*, Jan. 21, p. 23) contained the following passage:

> The committee expressed its determination to complete its work on the main features of a reformed international monetary system in the coming months. They recognized that, in the light of the recent developments in the world economy noted above, priority should be given to certain important aspects of reform affecting the interests both of developed and developing countries, with a view to their early implementation. Other aspects of reform could be agreed with the understanding that their operational provisions would be developed and implemented at a later date.

This statement has been widely interpreted as an indefinite postponement of detailed work on the essentials of reform as they had been repeatedly and authoritatively stated since the Nairobi meeting. Indeed, on page 21 of the issue of the *IMF Survey* from which the quotation above was drawn, the gist of reform was once more summarized as follows:

There is already an emerging consensus concerning the broad features which are desirable in a reformed system. Let us remind ourselves what these features are. In the first place it is agreed that the exchange rate system should be based on stable but adjustable par values, with provision for floating in particular circumstances. It is also agreed that in a reformed system, the volume of global liquidity should be under effective international control. This will involve making the SDR the central reserve asset of the system and establishing arrangements for the convertibility of currency balances accruing to monetary authorities through their intervention operations. Within the rules that are established for adjustment and convertibility, it is accepted that rights and obligations should apply symmetrically to deficit and surplus countries. Finally, there is widespread recognition that whatever new arrangements are devised should take full account of the needs of developing countries.

A span of a few weeks in the evolution of international monetary relations is a very short period indeed, yet the immediate impression one gets from reading this text today is of a paradigm so remote from anything resembling present circumstances that it invites a comparison placing in strong relief the argument developed in this essay. In this connection, the reader is referred to Robert Triffin's *The Evolution of the International Monetary System: Historical Reappraisal and Future Perspectives* (Princeton Studies in International Finance No. 12, Princeton, N.J., 1964). On the second page of this study, Triffin gives what he calls a "textbook abstract" of the functioning of the gold standard. He then remarks that "this highly simplified digest of the theory of international adjustment under the actual gold standard certainly meets the first test of an economic theory, i.e. the test of logical consistency." After questioning whether it meets "equally well the second test by which a theory should be judged, i.e. its conformity to the major facts calling for explanation," he proceeds to demonstrate the wide differences between the facts and the theory of the gold standard.

Reading the Nairobi Outline today and other documents related to international monetary reform prompts the same reaction: the logic is excellent, but what about conformity to the facts? Speculation on this question has now become a favorite topic, but perhaps the most direct and authoritative reaction to it came recently from Jelle Zijlstra, the President of the Central Bank of the Netherlands and Chairman of the Board of the Bank for International Settlements. In a communiqué published by Reuter's on March 13, Zijlstra is quoted as saying in a speech to the Zurich Economic Society (to be published by B.I.S.): "It is now beginning to look as though the dollar is on the way to regaining the position it had in the 1960s."

The second development related to the theme of this essay occurred over the weekend following the Rome meeting. On Saturday, January 20, the French authorities declared that official intervention designed to keep fluctuation in the rate of the French franc within the European "snake" would be "temporarily" suspended as of the following Monday. This announcement has been interpreted as one of the most important moves affecting the future of the scheme for European Monetary Union. Three important European currencies are now floating independently (the British pound, the Italian lira, and the French franc); a "joint float" is still maintained between the German mark, three community currencies (the Belgian franc, the Dutch guilder, and the Danish crown), and the currencies of neighboring countries (e.g., the Norwegian crown and the Swedish crown) under more or less loose arrangements and practices. The question of how these arrangements will evolve in the future is a fascinating topic for speculation. It will be of great interest to watch the extent to which "history repeats itself but with certain differences." The development of the mark as an international currency is not taking place in exactly the same way as the two best-known precedents, the pound and the dollar. In the European monetary arrangements, the "rules of the game" correspond more to those of a multiple-currency intervention system, the point of which is to establish a symmetry of rights and obligations among the currencies concerned, rather than to those of a key-currency system. But this may be a very superficial view, and whether we resort to the key-currency concept formulated decades ago by John H. Williams or to the notion of the optimum currency area proposed by Mundell, McKinnon, and others in the 1960s, further erosion of the monopoly of "local princes" with respect to the issuance of currency in their own domains will continue to characterize monetary relations in Europe, perhaps more markedly than before, now that the dollar is once more resurgent and the mark triumphant!

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* 86. Richard N. Cooper, *Currency Devaluation in Developing Countries.* (June 1971)
* 87. Rinaldo Ossola, *Towards New Monetary Relationships.* (July 1971)
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* 89. Franco Modigliani and Hossein Askari, *The Reform of the International Payments System.* (Sept. 1971)
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94. Alexandre Kafka, *The IMF: The Second Coming?* (July 1972)
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96. Michael V. Posner, *The World Monetary System: A Minimal Reform Program.* (Oct. 1972)
97. Robert M. Dunn, Jr., *Exchange-Rate Rigidity, Investment Distortions, and the Failure of Bretton Woods.* (Feb. 1973)
98. James C. Ingram, *The Case for European Monetary Integration.* (April 1973)
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105. F. Boyer de la Giroday, *Myths and Reality in the Development of International Monetary Affairs.* (June 1974)

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16. Ronald I. McKinnon and Wallace E. Oates, *The Implications of International Economic Integration for Monetary, Fiscal, and Exchange-Rate Policy.* (March 1966)
17. Egon Sohmen, *The Theory of Forward Exchange.* (Aug. 1966)
18. Benjamin J. Cohen, *Adjustment Costs and the Distribution of New Reserves.* (Oct. 1966)
19. Marina von Neumann Whitman, *International and Interregional Payments Adjustment: A Synthetic View.* (Feb. 1967)

[1] A list of earlier publications is available from the Section, or consult the publications list in earlier essays. A few of these publications are still available at the Section.

20. Fred R. Glahe, *An Empirical Study of the Foreign-Exchange Market: Test of a Theory.* (June 1967)
21. Arthur I. Bloomfield, *Patterns of Fluctuation in International Investment before 1914.* (Dec. 1968)
22. Samuel I. Katz, *External Surpluses, Capital Flows, and Credit Policy in the European Economic Community.* (Feb. 1969)
23. Hans Aufricht, *The Fund Agreement: Living Law and Emerging Practice.* (June 1969)
24. Peter H. Lindert, *Key Currencies and Gold, 1900-1913.* (Aug. 1969)
25. Ralph C. Bryant and Patric H. Hendershott, *Financial Capital Flows in the Balance of Payments of the United States: An Exploratory Empirical Study.* (June 1970)
26. Klaus Friedrich, *A Quantitative Framework for the Euro-Dollar System.* (Oct. 1970)
27. M. June Flanders, *The Demand for International Reserves.* (April 1971)
28. Arnold Collery, *International Adjustment, Open Economies, and the Quantity Theory of Money.* (June 1971)
29. Robert W. Oliver, *Early Plans for a World Bank.* (Sept. 1971)
30. Thomas L. Hutcheson and Richard C. Porter, *The Cost of Tying Aid: A Method and Some Colombian Estimates.* (March 1972)
31. The German Council of Economic Experts, *Towards a New Basis for International Monetary Policy.* (Oct. 1972)
32. Stanley W. Black, *International Money Markets and Flexible Exchange Rates.* (March 1973)
33. Stephen V. O. Clarke, *The Reconstruction of the International Monetary System: The Attempts of 1922 and 1933.* (Nov. 1973)
34. Richard D. Marston, *American Monetary Policy and the Structure of the Eurodollar Market.* (March 1974)
35. F. Steb Hipple, *The Disturbances Approach to the Demand for International Reserves.* (May 1974)

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1. Gottfried Haberler, *A Survey of International Trade Theory.* (Sept. 1955; Revised edition, July 1961)
* 2. Oskar Morgenstern, *The Validity of International Gold Movement Statistics.* (Nov. 1955)
* 3. Fritz Machlup, *Plans for Reform of the International Monetary System.* (Aug. 1962; Revised edition, March 1964)
* 4. Egon Sohmen, *International Monetary Problems and the Foreign Exchanges.* (April 1963)
* 5. Walther Lederer, *The Balance on Foreign Transactions: Problems of Definition and Measurement.* (Sept. 1963)
* 6. George N. Halm, *The "Band" Proposal: The Limits of Permissible Exchange Rate Variations.* (Jan. 1965)
* 7. W. M. Corden, *Recent Developments in the Theory of International Trade.* (March 1965)
8. Jagdish Bhagwati, *The Theory and Practice of Commercial Policy: Departures from Unified Exchange Rates.* (Jan. 1968)
9. Marina von Neumann Whitman, *Policies for Internal and External Balance.* (Dec. 1970)

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11. Fritz Machlup, *The Transfer Gap of the United States.* [Reprinted from *Banca Nazionale del Lavoro Quarterly Review*, No, 86 (Sept. 1968)]
12. Fritz Machlup, *Speculations on Gold Speculations.* [Reprinted from *American Economic Review, Papers and Proceedings*, Vol. 56 (May 1969)]

13. Benjamin J. Cohen, *Sterling and the City*. [Reprinted from *The Banker*, Vol. 120 (Feb. 1970)]
14. Fritz Machlup, *On Terms, Concepts, Theories and Strategies in the Discussion of Greater Flexibility of Exchange Rates*. [Reprinted from *Banca Nazionale del Lavoro Quarterly Review*, No. 92 (March 1970)]
15. Benjamin J. Cohen, *The Benefits and Costs of Sterling*. [Reprinted from *Euromoney*, Vol. 1, Nos. 4 and 11 (Sept. 1969 and April 1970)]
16. Fritz Machlup, *Euro-Dollar Creation: A Mystery Story*. [Reprinted from *Banca Nazionale del Lavoro Quarterly Review*, No. 94 (Sept. 1970)]
17. Stanley W. Black, *An Econometric Study of Euro-Dollar Borrowing by New York Banks and the Rate of Interest on Euro-Dollars*. [Reprinted from *Journal of Finance*, Vol. 26 (March 1971)]