Great money controversy

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It seems that most Americans have been taking the international monetary system for granted. We’ve assumed that it will keep on working well—and that in any case it can’t have much impact on our dollar.

But events of the past few months, stemming chiefly from Britain’s devaluation of the pound, suggest that we had better take a second look at these assumptions.

We realize now that monetary developments in faraway places could ultimately strike at our entire economy. What happened last November made this clear. When Britain devalued the pound sterling to solve her monetary crisis, she also raised her interest rates to help suppress her rampant inflation. Our interest rates had to follow suit, primarily to keep American capital from rushing to London.

Result? Tougher borrowing in the U.S., with all the attendant impact on our domestic economy. And then came President Johnson’s dramatic New Year’s Day report that our 1967 balance of payments deficit would exceed expectations and would require new controls over foreign investment, lending, and travel.

All of these developments served to focus attention on the entire worldwide monetary system itself. In particular, they threw the spotlight on the international role of the dollar, now the world’s chief reserve currency, and on the global effects of our balance of payments deficits, dollar outflow, and gold drain.

Americans—businessmen and housewives, alike—suddenly realized they had been ignoring these questions too long. Many a conscientious citizen had to admit how little he knew about monetary matters—the role of gold, the function of reserve currencies, and so on—but at least he now could see their vital importance.

Fortunately, concern about the world’s monetary apparatus has been shared for some time by statesmen and monetary experts. This year will see the
beginning of a new global debate on what to do about it, and this open airing of many of the complex problems involved will be a great help to the average person in his attempts to understand them.

The debate will turn around a plan now being prepared by the International Monetary Fund (IMF) which President Johnson has said is now “vital to speed up.” This plan seeks to help the world absorb future monetary shocks by the creation of what are known as “Special Drawing Rights” (SDRs) for member nations of the Fund. The SDRs have been called “a new kind of money” and hailed by some as a major step forward in world monetary reform.

On March 31, the IMF, headquartered in Washington, is scheduled to have completed work on the plan, which was authorized in principle at the 1967 annual meeting of the Fund, held in Rio de Janeiro. When the completed plan receives the approval of the IMF’s Executive Board, it will be submitted to each government for ratification. In order to take effect, it will have to obtain the approval of enough of the 107 member nations so that the affirmative vote represents at least four-fifths of the Fund’s total voting power, which is allocated among members in proportion to their assigned quotas in the Fund.

The plan is a response to a premise accepted by most experts in international monetary matters. This premise holds that the present world monetary system has served remarkably well since the end of World War II, when it was established, but that without substantial revision it cannot be expected to serve effectively for many more years. Some even fear worldwide monetary and economic chaos if changes are not made fairly soon.

What are some of the grounds for these fears? Why has the system seemed to work well so far? Why might it stop doing so? What are some of the conflicting interests and forces which may affect the shape of any revisions made? What are some of the implications this subject has for American business planners?

The Present System. Built around the central core of the IMF, the present gold exchange standard system is based on gold and two “international reserve currencies”—the dollar and the pound sterling. The IMF provides a system for multilateral surveillance and cooperation which was designed at the end of the war to provide the monetary stability and liquidity necessary to put world trade back on its feet.

The original IMF plan has been elaborated in the intervening years and has succeeded in accomplishing its objectives during a period of unparalleled international economic expansion, primarily by providing access for IMF members to a pool of gold and currencies established according to country quotas. Each country pays into the Fund one-fourth of its quota in gold (and can draw foreign currencies equal to its initial gold subscription) and three-fourths in its own currency.

Since each nation is restricted by its quota, the system can provide only a limited flexibility and does not constitute a charter for economic and financial profligacy. Roughly speaking, it acts as a fairly tight worldwide “credit rating” system, a way in which the assets and liabilities of a country—its present worth and future potential—can be measured, in a broad sense, on a consistent basis.

If a country under special circumstances falls below what might be called the general standards of “creditworthiness”, it may well be given temporary credit by the Fund, since not to do so might result in international financial dislocations. But these credits are controlled, and it cannot simply rely upon the international mechanism to rescue it automatically. Its government is expected to exercise internal monetary and fiscal discipline in the interests of international monetary stability and to restore equilibrium in its international financial position as soon as possible.

During the years since the end of the war, the expansion of world trade has been accompanied by a corresponding expansion in the need for monetary reserves. In the years from 1951 to 1965 the total monetary reserves of governments grew by $20 billion, from $50 billion to $70 billion. During this period, however, the amount of newly mined gold finding its way into mone-
tary reserves, rather than to industrial use or private hoarding, has never been adequate to supply the worldwide demand for reserves. New gold supplied only 40 per cent of the total increase in monetary reserves during this period.

Despite this fact, the individual nations were able to acquire the reserves they needed because of one basic circumstance: the balance of payments deficits of the United States. It was because of the tremendous outpouring of U.S. dollars resulting from U.S. deficits that the other nations were able to meet their reserve needs either by holding their dollars or by converting them into gold from the substantial U.S. gold stock.

Many experts feel that, so long as the U.S. balance of payments deficits continue, there is no immediate need for new measures to assure adequate monetary reserves for other countries.

But it has long been clear—and President Johnson has now reaffirmed it—that the United States cannot afford to permit the persistent "gold drain" to continue indefinitely. Apparently there is fear in some places that if the imbalance were prolonged, the U.S. might well find itself obliged to abandon its now-historic policy of buying and selling gold at $35 an ounce, regarded by many as the "centerpiece of stability" in the international payments mechanism.

Some observers also think that, had it not been for the Vietnam war, the payments imbalance would probably have long since been righted. The excess of our exports over our imports (our "balance of trade") has been consistently favorable, so they feel that removal of expenditures for the war would produce payments equilibrium quickly. In fact, according to the Secretary of the Treasury, equilibrium could result "within months," or within a year at most, of the war's end.

To the extent that U.S. equilibrium became a reality following a cessation of hostilities, the lubricating agent which has helped the system to function satisfactorily would have been diminished. To that extent, therefore, there would be a clearcut need for some new way to supply the reserves needed by other countries.

But the United States could not afford to await an end of the war as a means of restoring equilibrium. Hence the stern new control measures announced on New Year's Day. Yet some observers feel these controls may still need to be joined by other measures the U.S. has so far avoided, such as tax increases and cuts in government spending.

The world will be anxiously watching Washington this year to see what effect the new controls on overseas investment, lending and travel may have and what other steps may be taken. To the extent that the measures succeed in restoring equilibrium, the need for new reserves will become all the more apparent.

The Proposed New Plan. The proposed plan for SDRs—Special Drawing Rights—thus responds to various threats to the present system, including the shortage of new gold and the potential disappearance of the lubricating dollar outflow and related gold drain.

It seeks to provide a new form of prearranged assistance whereby a nation finding itself with a deficit—obliged to pay out more abroad than it has taken in—can obtain the currencies it needs to make its payments.

It seems misleading to regard the SDRs as a "new form of money," as some have called them, since the SDRs really would be nothing more then entries on a country's "special account" with the IMF, as opposed to its "general account." The public would never deal in SDRs.

The amount of SDRs credited on a country's books would be in proportion to the quota for its general account. The United States, for example, which at present has a quota of about 24 per cent, might be issued something like $250 million worth of SDRs each year for an initial five-year period. A smaller country would receive a correspondingly smaller amount.

Faced with a payments deficit, a country would set in motion a kind of
bookkeeping transaction with another country. Thus, Germany might be requested to accept a certain amount of Brazil's SDRs in return for some hard currency needed by Brazil to carry out its international transactions. If Germany agreed, a bookkeeping transfer of SDRs would be made from Brazil's account to Germany's and of the hard currency from Germany's account to Brazil's. Brazil would then be able to meet its obligations in that currency but would be obligated to redeem its SDRs later.

For many hard-pressed countries facing chronic deficit problems, the plan may well seem a panacea, a way of "bailing them out" of their difficulties and permitting them to postpone the unpleasant internal measures they would eventually have to take in order to correct their imbalances.

This is precisely why the debate which has arisen about SDRs focuses not so much on their desirability as on how to time their ultimate utilization. The argument turns around the question of when they should actually be brought into play and under what circumstances.

Basically two camps have formed over this issue. One favors implementation of the drawing rights scheme at the earliest possible time, under "liberal" conditions. The other favors postponement of actual implementation until the needs have become fully manifest and then only under the most stringent and carefully controlled conditions.

In a sense, this polarization reflects the fact that, for all the changes the world has seen in the last two hundred years, the globe can still roughly be divided into an "Old World"—basically Europe—and the "New Worlds"—the new, developing nations, with the United States perhaps representing "the oldest of the new."

Thus, the older nations, while they favor the economic development of the new nations, want to see that development as part of a disciplined, "programmed" evolution into the future, checked and balanced in its pace and structure by historic economic factors and relationships. Broadly speaking, France represents the leadership in this group, and French thinking has a considerable effect on the thinking of her partners in the European Common Market on matters of monetary policy.

These European desires come to the fore as the Europeans, led by France, insist on a stronger voice in controlling decisions over the release of SDRs. Specifically, they want to increase the percentage of voting power required for decisions—from 80 per cent to 85 per cent. Thus their 17 per cent quota would in effect give them a "veto power" over decisions which might seem to them to be too fast moving, perhaps reckless. Under the present requirement of 80 per cent approval, only the United States, with its 24 per cent quota, enjoys such a "veto power."

This desire arises precisely because of the "Old World" fear that the U. S., as the leader of the new nations, might urge too speedy a course of action, one which might satisfy the temporary needs and desires of the new nations but might lead to what the Europeans would regard as "international fiscal irresponsibility."

The Europeans have not confined themselves, however, to implying that the United States might favor policies likely to encourage recklessness on the part of others. They have remarked that the persisting American payments deficits suggest poor fiscal and monetary management on the part of the U. S. itself. The implication is quite clear: a country that cannot (for whatever reasons) maintain its own balance cannot be expected to encourage others to do so.

Tropical Agriculture and Capital Investment. This basic conflict of objectives between the United States and Europe comes into sharp focus in connection with the needs and problems of the crop-dominated tropical countries of the world, chiefly those of Latin America and Africa.

It is these countries—the producers of coffee, cocoa, bananas and other products subject to sharp seasonal fluctuations—that feel most urgently the
need for liberalized monetary drawing rights.

When things go well for them, when prices are up on the world market and they have successful selling years, they are likely to have little difficulty with their payments.

But when things go badly, when prices are down and their returns are low, they feel sharply the need for currency reserves to keep up imports and otherwise maintain their patterns of payment.

If the French-led approach were to prevail—implementation of the drawing rights plan on a very conservative, tightly-controlled basis—most of these countries would not find themselves benefited sufficiently by the plan.

Irrespective of what decisions are ultimately made over drawing rights, the chief route to payments equilibrium for most developing countries probably lies in capital investment for domestic industrial production of goods presently being imported. To the extent that new productive facilities cut down the need for imports, a country’s payments position—all other things being equal—is bound to improve.

Where to get the capital for the new flour mills, textile plants and brickyards—at reasonable rates of interest—is one of the most serious problems these countries face.

If they can find it in the near future, their monetary reserve problems could become progressively less acute over a span of years ahead. If they cannot, their problems remain.

Here, then, is the reason why all of the discussions over IMF drawing rights sooner or later involve corollary discussions over the future of the World Bank’s “soft-loan” affiliate, the International Development Association.

The IDA was created precisely to provide long-term loans on easy terms to foster projects which could enable countries to strengthen their economies and thus improve their international payments positions.

Unfortunately, the IDA can move only as fast and as far as the resources it receives from the eighteen industrialized nations which contribute to it will permit.

Anxious to accelerate the pace of IDA operations, the United States has pressed its associates to increase their contributions in the next few years—the years in which capital investments designed to reduce imports would have to be made if their effect is to be felt in time to head off monetary crises for many countries.

Response to the American initiatives has been unenthusiastic, with most of the eighteen co-sponsors more interested in encouraging the United States to increase its contributions than in augmenting their own.

Thus the future of the IDA’s budget becomes an additional subject for discussion in tandem with that of the IMF drawing-rights plan.

As the United States continues to press the issue, it will undoubtedly be seen that here again a divergence of objectives between the “Old World” and the “New World” must be recognized. Reduction of imports by many of the developing countries in many cases will mean a reduction of exports to those countries by the European countries from which they have been buying. Does Europe look with favor on this? Obviously the answer depends on specific products and specific countries, but it is not too difficult to see that it will be unpalatable to many a European manufacturer.

Whither Britain? As this confluence of conflicting forces comes to bear on the future of the international monetary system, it becomes increasingly apparent that the most significant imponderable in the complex is the future of Britain in the aftermath of devaluation.

Side by side with the debate over monetary reserves and capital development runs the dialogue between Britain and the European Common Market countries over her proposed membership. And this dialogue focuses ever more sharply on the monetary conditions which the “Six,” led by France, might impose upon Britain as a condition of membership.

In its early phases, this dialogue tended to deal with questions either of a broad politico-strategic nature or of a commercial character. Was Britain prepared to “join Europe,” as France insisted, thus cutting her ties in a strategic sense with the Commonwealth and the North American Colossus? Could Britain be a good member of the
"European family?" Would Britain fight for preferential treatment for Australian agricultural products in the Common Market area, for example, or would she let them go by the board?

As the discussion progressed, however, it became more clear in the eyes of some Common Market planners, particularly the French, that British membership would have to be accompanied by sweeping changes in the international status of the pound sterling.

In the world monetary system set up after World War II, sterling has clearly taken second place to the dollar as an international reserve currency. But this does not mean to say that its worldwide importance has disappeared. The key components in world monetary reserves remain gold, the dollar and sterling.

But if Britain joins the Common Market, what becomes of sterling? Does it continue to play its role as an international reserve currency?

Depending upon the urgency with which Britain views her need to join the Six, the price may well be not only an enforced restoration of Britain's balance of payments equilibrium but some kind of transformation in sterling's present role as an international reserve currency.

Impact on American Business Decisions. American companies attempting to develop long-range programs will find it essential to watch this worldwide debate over the international monetary system, with all its multifaceted complexities, during the months and years ahead. In one way or another the decisions taken will sooner or later affect the course of their affairs, whether their focus is international or domestic.

For example, payments deficits and domestic inflation may yet drive the U. S. to those classic techniques for controlling inflation and deficits which it has striven for many years to avoid—higher taxes, reduced government spending, still higher interest rates, and even wage-price controls.

The ways in which these methods might be used could easily spell danger to the domestic economy even while helping to dampen inflation and stem the gold drain. They could lead to stagnation of the economy unless the control throttles were operated with the utmost skill. Certainly the implications for business planners would be momentous.

But the long-range consequence of the new direct controls over investment abroad could be equally alarming. After all, the main impetus behind the rush of American corporations into manufacturing operations abroad, particularly in the Common Market area, has been the danger they foresee to their sales positions if they fail to get firmly established within the emerging tariff world of the new Western Europe. Prolonged maintenance of direct controls over their investments would surely weaken long-range plans for competitive growth.

From another point of view, planners concerned primarily with exports from the U. S. to commodity-producing countries subject to frequent payments crises will be anxious to see the development of monetary reserves adequate to support a continued rise in international trade.

It is quite clear, for all of these reasons and many others, that American business planning is affected at numerous points by a host of problems relating in one way or another to the basic issue of international monetary liquidity and stability.

Few observers, however, would attempt to predict just how much the IMF's proposed SDRs would contribute to solving the international difficulties faced by U. S. business, even though the President's desire to speed up their preparations has brought them new prominence.

But the present worldwide debate on monetary reserves—in which the question of SDRs is but a central point around which other issues turn—cannot fail to be salutary for business planners to the extent that it brings basic questions and opposing viewpoints into sharp focus.

American businessmen—and their accountants—will want to monitor the progress of this debate as closely as they can. The more they understand this complex problem and see its potential effects on their own planning, the more likely they are to make sound projections and wise decisions. In so doing, they may well contribute substantially to worldwide financial and economic stability.