

GOLD AND INTERNATIONAL MONETARY STABILITY

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In this paper I shall consider three aspects of the problem of international monetary stability, by which I mean exchange rate stability: (1) Under what conditions is exchange rate stability possible; (2) under what conditions is it desirable; and (3) would gold be helpful in bringing it about? Perhaps at some future time money will not only be denationalized but also completely privatized; and countries will no longer establish rules about legal tender. The whole question of international monetary stability as posed here will then become academic, but we are not quite there yet.

1. Exchange rate stability is possible only among economies that have similar growth rates for their supplies of transactions balances (denominated in the "home" currencies), adjusted of course for differences in the growth of demand for such balances. We should note, however, that the growth of demand for transactions balances depends not only on the growth of output, but also on portfolio considerations and other factors. It should also be evident that exchange rate stability does not imply price level stability.

2. Regarding the desirability of exchange rate stability, I would make the following points. Given the demand for transactions balances, one can create institutions that will favor the adaptation of the supply of transactions balances to produce a stable exchange rate. The practical question that presents itself is: What would then happen under various economic conditions? The answer is well known: Unless costs in the relevant economies tend to move in step, the effects on employment and GNP growth of adapting the supply of transactions balances to preserve exchange rate stability can become

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intolerable. I assume that the adaptation of the supply of transactions balances so as to produce exchange rate stability does not guarantee—at least in the short-run—that costs move in step. Since the collapse of the par value system, great progress has probably occurred in bringing the movement of money supply and costs in the main industrial economies into step. Prospects then are better than for a long time that prices will move in step. According to the latest estimates, the maximum divergence between the annual rates of change of the GNP deflators in the three main industrial countries—the United States, Germany, and Japan—between the first and the second half of 1983 would be 1.9 percentage points. The rates of change would be respectively 4.1 percent for the United States, 3.2 percent for Germany, and 2.2 percent for Japan. This compares with a maximum average divergence of 1.2 percentage points during the 10 years preceding 1973. During this period various revaluations of currencies occurred; net of these revaluations, the differences would have been larger. The maximum divergence between these three countries' deflators was no less than 11.8 percent in 1974. Hence we have come a good deal closer to a marching in step of prices, and one must assume also of costs, money supplies, and so on.

At the same time there is increasing disappointment—at least outside the economics profession—with the behavior of exchange rates and with the present managed float. It is, as we all know, an extraordinarily queer system. When we were writing the second reform of the Articles of Agreement of the International Monetary Fund, we could find no better way to describe the system than “an international system of the kind prevailing on January 1, 1976.”

It is certainly too early to return to a par value system, but to borrow an expression used some years ago by former French President Giscard d'Estaing, “a system of more viscous exchange rates” than the present one might be considered. Such a viscous system already exists: it is the European Monetary System. It is a par value system with rather wide margins and occasional par value changes. It might not be altogether fanciful to think that the time may be approaching when the European Monetary System or something like it could be expanded beyond the frontiers of Europe. This would, however, require not only similar cost, money supply, and price trends, but also improved coordination of fiscal policies. Without this latter requirement incipient interest rate movements might require excessively large interventions to insure stability of exchange rates. The supply of capital to any country, in other words, might not be infinitely interest elastic.

An expanded European Monetary System could be run in terms of

a gold standard or any other standard. It could also be run—or even is being run—without any common denominator simply by the establishment of a grid of exchange rates.

3. We come now to the final question: What would be the advantage of running a more viscous system or an eventual par value system, if either became possible or desirable, on the basis of a gold standard, by which I mean a gold bullion standard? A viscous or par-value-type system of exchange rates requires either reserves or a system of swap agreements between central banks.

In a gold bullion standard the reserves would have to consist of gold. While interconvertibility of national transactions balances could be assured under a different reserve system, past experience shows that the effects or suspected effects of using reserve currencies can create both inflationary and deflationary problems for the world economy. To rely on gold reserves alone makes the world hostage to the growth rate of gold production and to the private demand for gold.

For the short period during which the international gold standard existed in the 19th century and up to World War I, the availability of gold supplies also created both inflationary and deflationary problems for the gold standard countries. One would prefer a reserve asset whose availability is sure to grow in some tolerable way, so that it does not impose excessively disagreeable price and employment fluctuations even if the monetary base multiplier in each country does not move in an offsetting fashion.

To meet this problem by a general revaluation or devaluation of gold in terms of all currencies was a possibility foreseen in the original Articles of Agreement of the IMF. This provision was never used, for good reason, namely, the knowledge that there might be a general change in the gold content of currencies could very easily lead to very destabilizing speculation.

For this reason it would seem to me much more sensible, once the time has come to establish a viscous system of exchange rates, to use Special Drawing Rights (SDRs) as reserves and presumably as the common denominator. The supply of reserves would then be internationally determined like the supply of gold. Nobody except the international financial community would have what General DeGaulle (referring to the dollar) used to call “the exorbitant privilege” of creating reserve assets.

SDRs were of course invented as a gold substitute, so there would be nothing unnatural about the above plan. SDRs could be defined as a certain quantity of gold; but in the system I envisage gold would probably have no operational significance. An SDR reserve should be more acceptable and also safer than using one or several reserve

currencies. Moreover, better than gold, the supply of SDRs would not vary stochastically since they would be internationally controlled.

For those who fear that such control would be discretionary, one could write a rule of growth into the agreement. This rule would not be subject to change by the governing authority of the system, but would require renegotiation of the agreement—presumably a complicated affair.

This type of SDR would presumably have to be capable of being held by private individuals, although there are ways around this as has been shown in a proposal made during discussions of the late Committee of Twenty.

It would also be necessary to deal with existing reserve assets, and my preferred method of doing so would be to absorb them into an SDR substitution account. I am not convinced, however, that it would be necessary in a new par value system, or even still less in a viscous system of exchange rates, to relate movements in reserves to movements in the supply of domestic transactions balances in any precise mechanical fashion. But the rules by which the various national monetary authorities would govern themselves in this respect would have to have some degree of similarity.

In conclusion, I believe we can have international monetary stability in the sense of exchange rate stability without gold; and such a system based on SDRs may have advantages over a more traditional gold standard.