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Article

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Defusing the Monetary Time Bomb

Bearing in mind the challenges and risks the world economy faces during the coming years, the reports by the Group of Ten and the Group of 24 on the functioning (and improvement) of the international monetary system leave a great deal to be desired. Both papers by and large recapitulate the traditional positions of industrialised and developing countries, with hardly any signs of new and constructive approaches.

As regards the functioning of floating exchange rates, both reports agree that the system does have shortcomings. The high short-term volatility of nominal exchange rates and the large medium-term swings in real exchange rates are regarded as obstacles to trade, investments and growth. Industrialised and developing countries, therefore, agree that greater exchange-rate stability is desirable. Opinions differ to a certain degree, however, on how this can be achieved. The Group of 24 would like to see target zones for exchange rates and foreign exchange market interventions, whereas the Group of Ten emphasises the "adoption of sound, credible, and stable policies in all countries".

Both papers advocate an intensification of cooperation in the economic policy field and a strengthening of IMF surveillance. However, both papers bypass the crucial question of how this (often voiced) desire should be translated into action. Despite all the declarations of intent which embellish the innumerable communiqués of the many cooperation forums of western industrialised countries, there has been an increase in current account distortions and, until recently, in exchange-rate misalignments between the USA and the remaining industrialised countries. The danger of a crash-landing by the dollar and a resurgence of the international debt crisis still hangs over the fragile and export-bolstered process of international economic recovery like a sword of Damocles.

One clear shortcoming of the attempts at cooperation within the triangle, USA – Japan – Western Europe, as well as of IMF surveillance, has been the lack of a common economic policy reference system. If applied pragmatically, the concept of target zones for exchange rates, which was rejected by a majority within the Group of Ten, could at least prove helpful in the current situation (albeit certainly not in all future cases). Now that the USA has also begun to feel the disadvantages of an excessively strong dollar, and in view of the fact that this high exchange rate has already been criticised for some time by Europe and Japan, a great deal would suggest that concerted action should be taken to push this exchange rate down to a generally acceptable, and perhaps on balance even advantageous, level rather than wait as if paralysed for the dollar to crash-land with all the uncontrollable implications involved. A conceivable first step would be to target the dollar at DM 2.50 and 200 Yen.

How could such an objective be achieved? To begin with, it is obvious that European efforts to fully utilise the scope for monetary expansion created by falling interest rates in the USA would tend to be counterproductive. A more meaningful approach would be to combine measures designed to bring down interest rates in the USA with greater, supply-oriented fiscal expansion in Europe and effective steps towards stimulating imports in Japan. Specific foreign exchange market interventions, in line with a "leaning with the wind" could, if need be, emphasise the exchange rate policy intentions. These interventions, however, should have no more than an auxiliary function.

Such a set of measures, to the realisation of which initial steps have been taken by the Group of Five at their meeting on 23rd September, would seem fundamentally suited to gradually correct the distortions in the international current accounts structure and curb the growth of American external debt – a time bomb for the world economy and the international financial system – without causing detrimental effects which might otherwise arise from protectionist interference with the international division of labour. There would be no need to fear any noticeably adverse effects upon stabilisation objectives in the USA or growth and employment objectives in Europe and Japan, provided, as is to be hoped, a soft landing is made somewhere near the intended strategic target. At the same time, this strategy would support the process of economic recovery in developing countries: the one-sided dependence on the American market could be gradually overcome, external debt in real terms reduced in the wake of the dollar's declining exchange rate, and the debt servicing burden lightened.

Indeed, concern is growing about a possible resurgence of the international debt crisis in spite of the recently concluded debt rescheduling agreements with Mexico and Argentina. It has become obvious that the (essential) internal and external economic adjustments in many debtor countries have aggravated social tensions and that any further adjustment demands would lead to severe hardship for large sections of the population, at the same time jeopardising previous stabilisation successes. It is therefore disquieting that the banks have not shown their appreciation for adjustment successes so far – the current account deficit of non-oil LDCs fell from US $ 108 billion to US $ 38 billion between 1981 and 1984 – by providing more fresh money.

Such restraint is understandable from the point of view of each individual bank. After all, especially the American banks have enough problematic domestic loans in their portfolio. Viewed from a global angle, however, the restrictive lending policy (together with certain conditions laid down by national banking supervisory authorities) tends to increase the risk of insolvencies of individual countries, with the resulting chain reactions threatening the stability of the world economy as a whole.

Therefore, the fate of the world economy is all the more dependent on the functioning of multilateral cooperation in the IMF, the provision of adequate funds by multilateral institutions, and sustained economic growth in industrialised countries. Economic policy cooperation within the Fund suffers from the fact that in practice industrialised countries insist on an asymmetrical surveillance and conditionality which by and large encumbers the debtor countries with the burdens of adjustment; at the same time developing countries tend to regard the Fund as the extended arm and disciplinary instrument of the industrialised countries and thus as more of a tormentor than a helper. Its role as a catalyst for private capital – an aspect emphasised in the Group of Ten report – is also viewed less positively in developing countries: the Fund is often compared to an octopus whose tentacles no-one can escape. These attitudes stand in the way of constructive cooperation in the Fund, a deficit which cannot be overcome by "technical reforms".

As regards the financial resources and financing facilities of the IMF, the Group of 24 has again presented an extensive catalogue of demands. A great deal would indeed suggest allocating new special drawing rights to developing countries, and also the idea of an interest facility should not be rejected right from the start. It should be clear, however, that the solution to the problems of the world economy cannot be expected by a mere restructuring of private into public funds. Sustained economic growth in industrialised countries accompanied by a further opening up of their markets to the products of developing countries remains an essential requirement. This, of course, cannot be prescribed by a reform of the IMF. The meagre output of the two Groups is thus also an expression of the fact that the world economy is suffering less from shortcomings in its monetary framework than from the inadequate use being made of the possibilities this framework offers.

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