'A way out of the monetary jungle', from Vision (June 1971)

Caption: In June 1971, Raymond Barre, Vice-President of the European Commission with special responsibility for Economic and Financial Affairs, grants an interview to the Swiss monthly economic publication Vision in which he sets out his proposals to eliminate monetary problems in Europe.

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A way out of the monetary jungle

Raymond Barre, a vice-president of the European Commission, is its key man on money matters. His way out of the monetary jungle: control of hot money flows; US self-discipline; IMF control of the expansion of gold, SDR and dollar reserves, with SDRs as a substitute, not supplement, for dollars. And eventually a system in which no national currency — "Eurocurrency" included — has a reserve role.

Vision: Europe has just come through a serious monetary crisis. Given the causes of this crisis, do you think we are safe from another similar upheaval?

Raymond Barre: The international monetary system is fundamentally undermined by the massive and persistent American balance of payments deficit; it is superficially dislocated from time to time by the movements of speculative capital, amplified by the Eurodollar market. It is thus vulnerable to accidents of the type we have just seen, which can be triggered off by rumours, official statements, or even by apparently insignificant economic changes. Such accidents will continue if nothing is done to avoid them in future.

Vision: What can be done quickly to avoid another crisis?

Barre: The important thing is for the Community to be protected against such accidents. That is why the Commission first suggested that the central banks within the Community should regulate the Eurodollar market, in cooperation with other central banks concerned. The Commission also proposed that EEC countries should take steps to stem the flood of speculative capital and apply a concerted policy towards foreign capital.

This means, principally, regulating the net foreign currency holdings of the commercial banks, controlling the international debts of non-banking organisations, and holding back the national currency equivalents of excessive quantities of foreign exchange offered on the market. It also means the suppression of interest payments on Community bank accounts opened by residents of outside countries, and even perhaps the introduction of negative "interest" payments on such accounts.

Finally, the Commission also proposed a study of a dual currency market system, which would allow for a "controlled rate" for current transactions and a "free rate" for capital transactions.

Vision: The measures you suggest smack of *dirigisme* and thus seem incompatible with an effective international capital market.

Barre: I know that old song about *dirigisme*, and personally I am not in favour of such policies. Moreover I believe that an international capital market is valuable. But the operation of this market is at present constantly distorted by the conditions attached to the supply of capital and by the huge volume of hot money. Are we passively to accept the law imposed by such a market and sacrifice the fundamental interests of our economies to certain doctrines and certain individual interests disguised under the sacred name of liberalism?

No national currency or financial market is left to its own devices. Why should it be any different for an international capital market? This is clearly a point on which international cooperation is called for.

Vision: But aren't controls of this type impossible to apply? There are always holes in exchange control regulations for instance.

Barre: No controls are perfect, I agree. But the important thing is not to seek perfection but to take action when it is necessary to do so. This is not the first time I've heard it said that certain measures are impossible to apply or ineffective. And yet, they get applied.

On May 9, I heard an eminent expert state that it was impossible to stop interest payments on non-resident accounts. Twelve days later the country concerned officially announced the introduction of just such a measure. Sometimes I wonder whether people don't actually prefer to remedy the effects of crises rather than prevent them happening.

Vision: Are floating exchange rates really incompatible with the proper functioning of the Common Market? After all, commodity markets are not too different from floating exchange rate currency markets and they work perfectly well.

Barre: I must confess I don't altogether understand the comparison. The exchange market has nothing to do with cotton or copper. An exchange rate is not a raw material or commodity price, it is a price which reflects the relative purchasing power of different currencies.

As for the first part of your question, it calls for an unequivocal reply, so far as intra-Community relations are concerned. The proper functioning of the Common Market, as it is today and as we hope it will develop in future, cannot be guaranteed with floating exchange rates. All those concerned in the Community's economy— not just those in agriculture — need monetary rules to play the game by. A change in fixed parities changes the game overall, but the rules remain the same; with floating exchange rates there are no longer any rules.

Of course floating exchange rates are fashionable, and a number of prominent economists favour them. But this would not be the first time that it has paid to be cautious, however attractive other alternatives may appear. One cannot exclude the possibility of some limited flexibility between Community currencies, as a whole, and others. But it must be one that would not leave our countries alone bearing the burden of the international adjustment of exchange rates.

Vision: Will the currency crisis have a delaying — or perhaps accelerating — effect on the future of the EEC's economic and monetary union?

Barre: The achievement of economic and monetary union may of course be affected. But no serious harm will be done provided things don't go on like this too long.

In fact, there are other much more important factors:

1. The readiness of present EEC members to carry out a policy of harmonious economic growth, supported by greater financial solidarity and by closer monetary collaboration.

2. The solution of the economic, monetary and financial problems linked to the enlargement of the Community, and the efficient economic management of the larger Community.

3. The adoption of a joint position on international monetary problems, especially on the dollar.

If these fundamental conditions are not gradually met, economic and monetary union will remain a mere document, an interesting one, maybe, but one without any relation to reality.

Vision: You say the latest crisis was essentially due to speculation. But the international monetary system is definitely ailing. Why?

Barre: To say the recent crisis was mainly speculative in character does not mean that one is unaware of the failings of the international monetary system. It is merely to recognise the immediate cause of the trouble.

That said, let's look at the root cause. No international monetary system can function properly when the largest country within the system is free of all need for discipline in its balance of payments and when other countries find themselves financing its payments deficit unconditionally and to an unlimited extent. Coexistence between the *de jure* system of Bretton Woods and the *de facto* system of the dollar standard (which is gaining ground) becomes daily more difficult. Hard facts will sooner or later force us to make choices, however nice it would be to put them off.

Vision: Would it be desirable to modify the parities between the dollar and European currencies? If so, who should take the initiative and how?

Barre: People talk of changing the price of gold, thereby reducing the value of the dollar and all other currencies against gold. They also talk of parity changes, either a devaluation of the dollar against all other currencies, or a revaluation of the major currencies against the dollar.

An increase in the price of gold would revalue American gold reserves in relation to other countries' dollar holdings, allowing a partial repayment of US debts. But it would in no way change the basic problem, which is that of the American balance of payments deficit. On the contrary, with confidence in the dollar returning, the dollar holdings abroad would just build up again.

To devalue the dollar, or to revalue other major currencies in relation to be dollar, would give the United States an advantage that neither the American trade situation nor their other operations on current account justifies. Nor would it eliminate the basic causes of the US deficit.

This deficit has of course been aggravated by inflation over the past three years, but it is principally due to the volume of American public spending, that is to say, to expenditure linked to the foreign policy of the United States. I fail to see how parity changes can bring any satisfactory solution to this situation.

In any case, when there is a state of fundamental disequilibrium requiring a change in parity, it is up to the country in difficulties to make the change, not other countries.

Vision: What problems do the pound and the sterling balances pose in relation to Britain's joining the EEC?

Barre: Britain's entry raises three basic problems in the economic, monetary and financial fields. They are:

1. The need for an economy with a low rate of growth, now and probably in the immediate future, to adapt to the higher rates of the other EEC countries. This problem is partly a structural one of the British economy. To some extent joining the EEC will provide a solution in itself. But in the long term much will depend on Britain's own efforts.

2. The possible disruptive effect on the Common Market of variations in the sterling balances. The Basle agreements indeed lessen the risk of wild fluctuations. But they do not provide a satisfactory or lasting solution because they do not prevent the sterling balances from rising above the level at which the agreements come into effect; above that level, the sterling balances could still vary abruptly.

3. The problem posed by the existence of a reserve currency subject to obligations and constraints external to the Community while the latter is gradually organising itself on the economic, monetary and financial level.

Unless the enlargement of the EEC is to be accompanied by a change in its objectives, these problems will have to be faced seriously, if they are not sooner or later to disrupt the proper functioning of the enlarged Community.

Vision: Does a devaluation of the pound during Britain's "transitional period" seem desirable to you?

Barre: Even if I had an opinion on that, I would keep it to myself.

Vision: Should a future European currency be a reserve currency?

Barre: A European currency is not going to exist tomorrow, so the question is theoretical. My feeling is that if there is one day a European currency it will be used for trade and finance purposes only. But I hope that by then we shall have an international monetary system in which no national currency will be a reserve currency. Reserve currencies have given us enough problems for us not to want to create more with a European reserve currency.

Vision: What reforms would you personally like to see introduced in the present international monetary system?

Barre: I'm not much inclined to go in for plans to reform the international monetary system, since they are usually pretexts for delaying needed action. Furthermore, it is less a question of a thoroughgoing reform of a system which has proved very useful for a quarter of a century than of solving two urgent problems: the need, in the near future, to regulate the movement of hot money; and the need to do something about growing dollar holdings abroad.

It is especially necessary that international agreement be reached on rules for a *controlled* growth of the various international forms of liquidity, that is, gold, dollars and Special Drawing Rights. This would mean a progressive slowing down in the increase of overseas dollar holdings and the creation of SDRs not as a supplement to dollars but as a substitute for them in international liquidity. It would also mean that the American balance of payments deficit would be absorbed in a normal way, by using US reserves or special credit from the International Monetary Fund.

Vision: How do you envisage the growth of these different forms of reserves would be controlled? Will more, or less, liquidity be necessary?

Barre: It would be the role of the International Monetary Fund to regulate the growth of international forms of liquidity. What is certain at the moment, though, is that there is too much rather than too little liquidity. The present situation should thus not serve as a point of reference.

Vision: Do you think the governments of an enlarged Community could formulate a joint attitude towards the dollar?

Barre: It would all depend what this joint attitude was. There would be no difficulty unless, while not being aggressive, it were nonetheless one of independence in relation to the dollar.

In any case, the governments of today's Community have failed to work out a common position towards the dollar, for well-known political reasons, even though their views on the American balance of payments deficit have been generally fairly close.

What will happen in an enlarged Community? International political factors will not disappear. In fact, there are some reasons to think that working out a common attitude will be more difficult. This is because the pound is a reserve currency, an advanced defensive position for the dollar, and because the London money market is closely linked with New York and is the centre of the Eurodollar market. Still, we may be agreeably surprised — at least that is what people say.

Vision: Do you think it possible to coordinate budgetary and economic policies effectively in a Community made up of ten countries?

Barre: There will be major problems. Progress in these fields has been slow enough with six countries. Having ten countries will bring more divergent factors into play. One can, of course, wonder whether the enlarged Community will in fact need as much coordination as the present Community. Here, as in other areas, much will depend on the nature of the enlarged Community.

Vision: What are the various alternatives?

Barre: The enlarged Community may retain its present form, which would require effort and discipline, or it may slide imperceptibly towards being a more flexible and looser organisation.

I think that a European organisation of a looser type would be unable, beyond the advantages of a large market, to satisfy certain aspirations for social justice and for an intra-Community as well as international solidarity that would enable Europe to run its own affairs and play its proper role in the cause of peace and progress. And it would have little future, because sooner or later it would disappoint the hopes of our peoples.

Is an organisation that could do those things no longer possible? If this is the case, let us stop deluding ourselves and build something else. But if, as I hope, there is still a chance of developing a truly European Community, let us take it quickly so that European countries can have a policy fitting their ambitions and also serving their interests.

Vision: How do you see the economic climate in western Europe at the end of this year? What causes you most concern?

Barre: In most of the EEC countries there will be substantial price rises, while growth and employment prospects will be satisfactory. Only in Italy will the situation arouse concern.

Expansion in 1972 does not seem to be threatened, but a slow-down in the rise of production costs and prices will remain a priority in the immediate future.

The tendency to inflation is self-perpetuating, and people expect it to continue. But the fact that appropriate correctives have so far been delayed must not lead people to think they can be avoided altogether.

Vision: If you had the power to impose today a major reform or decision affecting all the EEC countries, which would you chose?

Barre: There is of course no magic formula. What is important is to choose an objective and to direct all economic policy measures towards attaining it.

In my opinion, this objective should be the defence of Community currencies, to protect their internal purchasing power and their value in international terms. This is the essential basis for the steady development which all our countries need.