The same view was expressed by Henri Basquiat in a paper for a Brookings Seminar, April 18-19, 1979. At that same seminar, however, Christopher McMahon referred to the possibility of a different development in the longer term when the ECU could become "a genuine reserve asset ..." He saw it as "an open question whether at a later stage it may be possible for monetary authorities outside the EEC — or even for the private markets — to hold ECU's."

As indicated, the official EEC view is in line with the underlying economics of the possible role of the ECU. It is in line also with the obligation of the EEC members, as members of the IMF, "to collaborate with the Fund and other members [toward the objective of] making the SDR the principal reserve asset in the international monetary system" (Article VIII, Section 7). In this connection one should also note paragraph 5.3 in the Resolution of the European Council of December 5, 1978 on the Establishment of the EMS: "The EMS is and will remain fully compatible with the relevant Articles of the IMF Agreement."

One way to underline the regional/global relationship between the ECU and the SDR would be for the EMF — once it gets lasting possession of the dollars contributed by members — to deposit those in the IMF's Substitution Account when that Account becomes operative. This would substantially reduce the exchange risk to which the EMF would be exposed, on the reasonable assumption that the ECU would fluctuate less against the SDR than against the dollar.

Jacques J. Polak

1. Pierre Languetin:

In order to remain brief, I will express myself in extremely simple, albeit in controversial terms. But first of all I must apologize for lacking the competence to speak on this particular subject. My country is not a member of the IMF, though it is sometimes referred to as a constructive non-member. We are not members of the European Monetary System although, through our own independent policy, we do endeavor to keep a stable relationship with European currencies and, indirectly, we do help to make the system work through cooperation with the Bundesbank, the Fed, and sometimes the Bank of Japan to maintain the stability of the dollar. The Swiss franc is not, of course, the dollar. However, the question is sometimes raised, particularly in present circumstances, whether it might in fact replace the dollar. In my view this would be possible only to the extent that a link could replace an ocean. Our position as outsiders will explain why my comments will not be as technical as Mr Polak's introduction and, needless to add, not as authoritative.

Even though we are, officially, outsiders, we have observed — with great interest and much concern — developments in various institutions, and we try to help whenever possible and desirable. As an observer, I would say in the first place that the natural inclination of most institutions is to give precedence to internal matters over external ones. I believe this also to be true of the IMF, even though my remark is less relevant in its case in view of its universal character than it is for other institutions. Nevertheless, it is worth pointing out that the holding of SDRs has been the prerogative of member countries only, with only one exception so far, and that the private sector has been excluded from the SDR system. So far, the possibilities of using SDRs have been very limited, though they have been extended recently. In my view, this inclination to deal primarily with internal matters applies also to the EMS. The Ministers' resolution has provisions for cooperation with European countries that have close economic and financial ties to the
Community, and for coordination of policies vis-à-vis the dollar. There have been no decisive achievements on these two goals yet, which is perhaps not surprising in view of the difficulties involved but results also from the clear priority given to internal matters. The question now arising is whether the same is going to apply in the case of the European Monetary Fund. This in turn raises the question of the ultimate purpose of the proposed EMF. Would it be — as I was immediately inclined to think — to support internal European integration? And would this be its one and only purpose? Or else, could its purpose be to improve the world situation and the sharing of the burden imposed by the world monetary system? Is it intended to contribute to the stability of international currencies?

I will not comment on internal matters here beyond stating that I am too much of a supporter of the European idea to doubt the usefulness of considering internal goals. My remarks will be confined to the external relations of the European Monetary Fund, and namely to three points: should this Fund provide a source of credit? A reserve asset? An intervention medium?

I do not believe that either now or in the future, there will be any need for additional sources of credit. When General de Gaulle was asked whether there would be a vacuum on his ceasing to be Head of State, he replied that there would be no vacuum but rather, a "trop plein" (an overflow). It seems to me that if you add up official and private credit sources you will have this "trop plein." You already have, inter alia, the IMF, the General Agreements to Borrow, and international bank lending.

In the present situation, however, we clearly need, or at any rate feel we need a measure of diversification of international currencies. There may be economic and monetary reasons for diversification to the extent that the existence of only one reserve asset inhibits spreading the exchange risk. There may be other, mainly political reasons. One such political reason was at the root of the emergence of the Euro-currency market: a country wishing to hold dollars but not necessarily in the United States. In this context, the substitution account (of which Switzerland not being a member of the IMF is not in a position to appreciate the usefulness) may well become even more important in view of this political element. There are of course other reasons for wanting diversification. I can see from the look on my German colleague's face that he knows exactly what I am talking about.

This leads me to the question already raised by others: could or should the ECU serve as a reserve asset?

The aim should neither be to compete with the dollar, nor with the IMF, but rather, to supplement the IMF's efforts, to provide a wider choice to asset-holders and perhaps, also to avoid the undesirable and even intolerable concentration of some currencies in reserve portfolios. Here, a few words on the Deutsche Mark are in order. It seems to me that the DM is in a very unusual position, torn between two worlds so to speak, the world as such on the one hand, and Europe on the other. Is it either conceivable or acceptable that this should go on for ever? Would it not be preferable to try to establish a broad base in the form of an ECU? Is it realistic to believe that this can be achieved? On re-reading Professor Triffin's paper, I was very interested to note his views on the substitution account, which would have embraced the dollar and the pound in one go, so to speak. I wonder whether this concept would not be helpful to European currencies. It might indeed provide a much broader basis to one of the international currencies: the German mark. Needless to say, this is not likely to happen tomorrow, but in any case we are not discussing the short-term, but rather the long-term perspective.

Another question I would raise is whether, in addition to being a reserve asset, the ECU could become an intervention currency. Although Mr. Polak may correct me on this point, the SDR is not an intervention currency and cannot ever be in present circumstances. This, I think, is highly significant. Of course, one could argue that a monetary system should not be constructed with the idea of intervention having to be resorted to. But this is far too ideal a view of the kind of world we live in. We must face the fact that intervention is going to be necessary, indefinitely. Now, one of the weaknesses of the present system is that you can hardly influence any particular currency without influencing others at the same time, and you have no standard for avoiding this in any case. For example, the yen was at one time in a depressed position. One way of putting this right was to intervene in dollars, even though the dollar's own position at the time was such that was hardly desirable for the Bank of Japan to sell a large amount of that currency. Nevertheless, this was the only thing it could do at the time. I believe that if the SDR cannot be an intervention instrument, the ECU might have sufficient economic backing — if constructed to that effect — to provide an adequate intervention standard. This is a very long-term prospect as I do not think any particular currency can be used as an intervention medium unless it can be held and traded on the market. You can influence your own currency only if you can intervene on the

1 See R. TRIFFIN: "The Future of the International Monetary System", Mi-
meo, 1979
market itself, and you cannot do this solely through operations between central banks.

No doubt many of you will regard my comments as unrealistic, and they would be right especially insofar as the immediate future is concerned. At the moment there is little on which to base my remarks except for one sentence in the Resolution of the European Community to the effect that two years after the introduction of the EMS, a European Monetary Fund should be set up. This is the only excuse for my unrealistic views.

I will conclude with two brief comments. First, the European Monetary Fund should be set up within a world, and not merely a European framework. In my view its aim should not be to compete with other institutions such as the IMF, but it should be in a position to push through a reform of the monetary system as a whole. Second, if the EMS can provide a certain amount of leadership in economic convergence, it would set an example for the rest of the world.

2. ROBERT MUNDELL:

The more I listen to discussions of currencies and new patterns of international relations, the more I am impressed by the many-sided aspects of these issues. I mean this as a truism since we can look upon the world monetary system as a set of institutions that have particular functions, we can look upon the systems that grew up inside that world as mechanisms for facilitating economic arrangements, we can see institutions and mechanisms as historical outcomes of an evolutionary process of the world economy. We can also view them as political institutions that are adjusting to changing political circumstances in the world. Jacques Polak, with his remarkable erudition and perceptive ness, has focused attention on the institutional aspects of the problem, but, of course, all other issues emerge or are latent in the background.

In meetings between academics and officials, such as this one, the function of the academic is not to imitate the official but to create his own role, which is to ask questions as they appear within the confines of his own knowledge, playing the role of a wild card in the deck, if only because the international issues that come up are very draconian in the effects they are likely to have on the international monetary system.

First of all, we are dealing with institutions that create money, and the purpose of creating money is to create inflation. The consequence of creating money is to create a means whereby we can define and have inflation. And that is not different whether we think of the creation of the IMF, the creation of the European Monetary Fund, or of the Federal Reserve System as the creator of the dollar, or of any of the different means that we have for creating inflation. Certainly over the 20th century the greatest engine of inflation that has been created has been the Federal Reserve System. It started off as a mere central bank, became — starting in 1914 — closely tied to the disciplined system of convertibility of the dollar into gold, but gradually evolved into a system which is creating not just inflation in the United States but throughout the world. The tenfold increase in reserves that has occurred since convertibility was dropped out of the system only reflects that fact. The constants of course remain in the system, and Jacques Polak has himself reflected on this. The ratio of gold to dollars is not nearly as different as one thinks, when one measures gold at market prices, from what it was under Bretton Woods. Gold and dollars are still the major assets in the system, even though gold has at least temporarily become a dormant asset. It is a dormant asset because it is underpriced, and nobody uses an asset that is underpriced. You only use assets that are overpriced in the system. This is Greenspan's Law: we have to have an overpriced asset in order to use it.

When Jacques Polak discusses the liquidity factor involved in the IMF and the EMU, he is asking an important and perhaps vital question, which goes far beyond a merely technical one. If you put existing assets into the system and then take them out, you are not creating assets, but if you put assets that do not exist into the system and take them out you are creating money. But by far the larger, wider aspect of this is the impact of the creation of new international assets on monetary policies. If you look at the SDR, for instance, nobody complains now about the injection of 10, 15 or 20 billion dollars SDRs into the international monetary system. But if the SDRs were responsible for the breakdown of the international monetary system in 1971 and in fact induced the United States to move ahead with a vastly more expansionary monetary policy in 1971 than they would have done had the SDR not been created, then the blame on the SDRs is vastly more important for world inflation than it appears. I think one can make the argument that the SDR may have played a role in creating more expansionary monetary policies on the part of the US system. So, the first point we have to make sure we know is that we will never know what the effect of the creation of such an important thing as a new world money is until after the event. Nobody could have predicted it in the past. Nobody can predict now the importance of the creation of the EMU. Both SDRs and ECU are new wild cards put into the system and we do not know where they are going to land. Behaviourally,