The Frank E. Seidman Distinguished Award In Political Economy

Acceptance Paper By

ROBERT TRIFFIN

The Intermixture of Politics and Economics In The World Monetary Scandal: Diagnosis and Prescription

Award Bestowed September 15, 1988

RHODES COLLEGE
Memphis, Tennessee

THE FRANK E. SEIDMAN DISTINGUISHED AWARD IN POLITICAL ECONOMY

The Frank E. Seidman Distinguished Award in Political Economy was established in memory of Frank E. Seidman by Mr. and Mrs. P. K. Seidman. The host college for the Award is Rhodes College, a liberal arts college established in 1848. An honorarium of fifteen thousand dollars will be given to an economist who has distinguished himself or herself internationally by contributing, in the judgment of his or her peers, to the advancement of economic thought along interdisciplinary lines and to its implementation through public policy.

The purpose of the Award is to recognize and encourage economists who are attempting to extend their work into the interdependent areas of the other social sciences. The Award is established with the expectation that social welfare will be advanced when proper cognizance is given to environmental and institutional influences upon the economic behavior of individuals and groups. The basis for evaluation will encompass both the synthesis of existing thought in political economy and the pathbreaking development of new concepts. The recipient of the award is chosen by the Board of Trustees upon the recommendation of a rotating Selection Committee composed of eminent economists.

The Award is presented annually at a formal banquet in Memphis, Tennessee.

Mel. G. Grinspan
Director

ROBERT TRIFFIN

Recipient of Fifteenth Annual
Frank E. Seidman Distinguished Award
In Political Economy

Memphis, Tennessee, September 15, 1988

Robert Triffin is best known for his contributions to world monetary reform and regional monetary integration. He played a leading role in the conception and negotiation of the *European Payments Union* and of the *European Monetary System*. He continues to cooperate in the studies aimed at promoting the evolution of the *EMS* toward the full *Economic and Monetary Union* envisaged as an ultimate goal by its creators and by the *Action Committee for the United States of Europe* of Jean Monnet, with whom he collaborated closely for many years.

Born in Flobecq, Belgium, on October 5, 1911, he has taught at Louvain, Harvard, Yale, Geneva, Louvain-la-Neuve, amongst others, and served as staff member, or consultant, with the Board of Governors of the Federal Reserve System, the Council of Economic Advisers of the President, the European Recovery Administration, the International Monetary Fund, the United Nations Economic Commissions for Europe, Latin America, Africa, and

INTRODUCTION OF THE 1988 RECIPIENT, ROBERT TRIFFIN, AND PRESENTATION OF THE AWARD

by
JAMES TOBIN

President Daughdrill, Dr. Bies, Mr. and Mrs. Seidman, ladies and gentlemen. I am proud to introduce to you my long-time mentor and colleague Robert Triffin. The pride I feel is that of bringing to you a friend for whom I have great admiration and affection, an extraordinary human being whom I know you will appreciate and like.

Robert, let me also introduce you to this audience. Memphis is a long way from Brussels, not even that close to Washington, New York, New Haven, and Boston. But, as you and Lois are finding out, your new friends here are not only extremely hospitable, but also deeply interested in political economy and political economists, among whom their tastes are sophisticated and discriminating.

Our paths, Robert's and mine, have often joined or crossed these past fifty years. He was a student generation ahead of me at Harvard, graduate student when I was an undergraduate, instructor when I was a graduate student. His generation was a spectacular group, making new economics while studying and teaching both old and new. (You have previously honored two other members, Galbraith and Musgrave, and I imagine you might have honored Samuelson if Stockholm had delayed doing so.) Robert Triffin's Wells Prize dissertation, making theoretical sense of Chamberlinian monopolistic competition, was on our reading lists as soon as it was published in 1940. No wonder my peers and I looked on Robert and his contemporaries with considerable awe.

Robert and I went different ways during the war—I refer to *our* war, the Second World War. He went to Washington, and from research and practical experience developed the interest that would dominate his career, international monetary economics. We had occasional contacts here and there, but our close association and long friendship began when Robert came to Yale in 1951, a year after my arrival. Robert's appointment was a great

coup, which, together with the recruitment of Henry Wallich, William Fellner, and the Cowles Commission in the space of four years, brought the Yale department up to world-class status.

Robert was a marvelous citizen of the department and the university—loyal, humane, wise, and tolerant. I had many reasons to be grateful for his presence and his counsel.

Robert's contributions to the university are less evident to the outside world than his publications and his public service. Let me mention just two. First, Robert founded and fostered a program to train economists sent by foreign governments for a year or two of graduate work, oriented to economic development and international economic relations. The program continues, and its alumni—many of them personally taught and inspired by Robert—occupy positions of importance and influence in central banks, ministries, and international organizations all over the world.

Second, Robert was Master of Berkeley College, one of Yale's twelve undergraduate residences, for years. He and Lois dedicated themselves to their 300-odd adopted adult children, who revered them with great affection. Robert's Mastership covered the era of student unrest and revolt, but Robert's sympathetic understanding of students' concerns and values, exemplified by the altruistic undertakings of his own sons, was an important factor in maintaining peace and civility in his college and throughout our campus.

I return to my personal narrative. In 1961 I joined President Kennedy in Washington as a member of his Council of Economic Advisers. When the three of us divided special responsibilities among ourselves, one of my subjects turned out to be international economic policy. I was not an expert; one could say I knew almost nothing. My first move was to prevail on Walter Heller to call in Robert Triffin as a consultant.

Back at Yale, Robert had taught me, as he was teaching students, colleagues, members of Congress, bankers, and anyone who would listen, about the inherent instability of the gold-dollar Bretton Woods monetary system. He called it right, well in advance. Other central banks, and private citizens, would not forever hold dollars as if they were as good as gold, while the gold backing of the dollars steadily diminished. Triffin's message was

that we needed concerted *international* action to meet the world's growing needs for liquidity.

Messengers who bring bad news are often unwelcome, and those who were managing the status quo didn't want to hear Triffin's message and didn't want anyone else to hear it either. As the Kennedy Administration began, the United States was beginning to feel the pains of payments deficits and gold losses, but the U.S. Treasury was certainly not ready for Triffin. The Cassandra who says the world is justifiably losing confidence in the dollar is working for the U. S. government?!

We did have some little successes—Robert, Dick Cooper, and I—and I certainly learned a lot of international economics. We know of course that Robert has had plenty of success in other theaters. He was a major architect of the European Payments Union, and of the European Monetary System.

In broader scope, Robert has always been a European, like his friends Jean Monnet and Robert Marjolin a builder of transnational European institutions. He's still at it, no doubt helping with the arrangements for the bold move scheduled for 1992. But Robert has never favored an inward-looking protectionist Europe. He would like to see a world-wide central bank, and other global institutions, particularly devoted to improving the lot of the Third World. And above all, Robert seeks world peace, disarmament, detente.

I have known very few people who believe so deeply in what they are doing and pursue their interests with such passion. Robert has always been in great demand, and supply, as a consultant to governments and international institutions. In one of his books he appended the word "regrettably" to the customary prefatory warning that the views expressed were not those of his employers and clients.

Robert has made powerful intellectual and scientific contributions throughout his career. But almost all the time his work has been geared to policy, to designing, repairing, and improving institutional architecture, in forms attractive to the disparate interests of the parties involved. I once heard Robert defend himself against the charge that his work consisted in inventing "gimmicks." Sure, he said, those are what we need, workable and sal-

able gimmicks. (I recall one he urged on Mossadegh in Iran: let the landowners assess themselves for property taxes, provided only that they must sell their land to anyone, including the government, who offers to buy it at assessed value.)

Inevitably Robert has been a student of politics and history as well as economics. No one could be better qualified for the Seidman Award, for "an economist who has distinguished himself or herself *internationally* (my emphasis)...to the interdisciplinary advancement of economic thought as it applies to the implementation of public policy.

Robert, old friend, it's for me a great honor and privilege to present to you the 1988 Frank E. Seidman Distinguished Award in Political Economy.

THE INTERMIXTURE OF POLITICS AND ECONOMICS IN THE WORLD MONETARY SCANDAL; DIAGNOSIS AND PRESCRIPTION

by
Robert Triffin

The "*Nobel Economic prize*" has been conferred nearly exclusively so far to pure economic theoreticians whose assumptions are dictated by mathematical convenience bearing little or no relation to reality and to the solution of the major problems confronting us today.

The prestigious "*Frank E. Seidman Distinguished Award in Political Economy*" conferred on me today by your prestigious Selection Committee aims, on the contrary, "to recognize political economists...concerned with improving the human condition..." Moreover, it stresses "the cross-fertilization of the other social sciences with economic behaviorial influences and values... and the path-breaking development of new concepts," while the Nobel economic prize tends to reflect *consensus*, rather than *dissent*, and within the economic profession only.

This official summary of your major objective will dictate the controversial tone and contents of my acceptance speech. I shall stress my dissent from the manifest *scandal* of official policies that have already led the world into the disastrous "*infession*"[1] of the last fifteen years (1974-1988), and threaten us tomorrow with the *nuclear suicide* of human life on our minuscule planet.

I POLITICAL DIAGNOSIS.

These horrendous policies reflect our governments' legitimate concern with national security against the threat of foreign aggression. They obey an old slogan—"*Si vis pacem, para bellum*!"[2] —that may have had some validity in former days, when

[1] This neologism, suggesting inflation followed by recession, seems to me far more accurate than the prevalent term of "*stagflation*" which suggests a mere stagnation followed by inflation.

[2] "If you wish peace, prepare for war!"

the economic and human costs of military aggression might be deemed outweighed by the conjectured benefits of territorial conquest and occupation. This slogan has, however, become merely absurd since any conceivable benefits of this sort must now be measured against the risks of nuclear escalation and *mutual assured destruction*, baptised "*MAD*" by its proponents themselves.

Yet, the mass media, financed by the "military-industrial complexes" denounced by President Eisenhower in his farewell address as a major treat to democracy, continue to divide the world simplistically into two opposite camps: the *peace-mongering* nations—their own, of course, and their allies—and the *war-mongering* ones: imperial America for the USSR and, for the United States, the "evil empire" of Soviet Russia and its subjugated nations.

Public opinion is led thereby to accept an over-rearmament race under which the United States seeks its security, and that of its allies, through the military superiority of NATO over the Warsaw Pact, and the USSR seeks its own security, and that of its allies, through the military superiority of the Warsaw Pact over NATO. Needless to say, they cannot both succeed simultaneously, and the race goes on therefore with two consequences:

1. Worldwide inflation, since military expenditures increase spendable incomes without any parallel increase of available goods and services on which they can be spent, nor of the real wealth from which taxes can be levied.
2. The growing threat of "preventive" aggression by the power deeming itself in danger of losing the race, or of miscalculation by either superpower of the other's intentions, such as—reportedly—the radar misreading of a flight of birds, etc. This diminishes, rather than strengthens, the security of both and of their allies.

As for the—approximately 180—countries other than the two superpowers, most of them are resigned to seek their national security in military alliances subordinating their pretended national sovereignty to the hegemony of either of the two superpowers, and accepting in all but in name the status of "*satellites*," or "*pro-*

tectorates" complying more or less supinely with the policies of their protector. Worst of all, they cannot but be aware that the "*nuclear umbrella*" protecting them is far more likely to remain unused, or to be used only over their territory rather than over the territory of their protectors, in view of the understandable reluctance of these to accept the risk of mutual destruction of their own military bases and population centers.

In the meantime, the "*cold*" war of the superpowers continues to entail a multiplicity of "*hot*" foreign and civil wars for the satellite countries of the Third World, with millions of military casualties and deaths from starvation.

II POLITICAL PRESCRIPTION

Who could doubt the longing of statesmen and of public opinion for switching from today's suicidal and inflationary over-rearmament race to a mutual reduction of overbloated defense expenditures, enabling a joint pursuit of optimal rates or *real*—rather than *nominial*—GNP growth, and of leisure-time compatible with decent living standards?[3] Yet this commonly shared goal will remain inaccessible through mere negotiations as long as each persists on *negotiating only from strength*, as adamantly advised by the "hawks," in the United States as well as in the USSR.

It is of course true that it takes two to preserve peace, but only one to impose war on both. The old observation of Clemenceau is still valid: War is too serious an affair to be left to the generals, and disarmament negotiations are bound to fail—as they have indeed for nearly 60 years, since the 1929 Aristide Briand initiative in the League of Nations—as long as politicians feel bound to leave them in the hands of their military establishment experts. The switch from a costly and dangerous over-rearmament race to a *mutual* race toward disarmament could be *initiated unilaterally*, without any danger whatsoever, by either of the two superpowers if their statesmen and public opinion recognized at long last that the time-worn slogan of "*Si vis pacem, para bellum*!" should be

[3]reducing thereby unemployment rates for the richer countries, and enabling the poorer ones to approximate living standards obviously unattainable for the world as a whole if the former continue to devote productivity increases to material consumption, such as two, or more cars per household, etc.

replaced today by President Roosevelt's slogan: "*The only thing to fear is fear itself*!" Since each of the protagonists is now sufficiently armed atomically to destroy several scores of times every citizen of the opponent country, it could safely afford to reduce its overflowing arsenal by a few percents, or much more, and hope that his protagonist will follow suit.

The opponents of such a disarmament race, in the United States as well as the Soviet Union, persist nevertheless to argue that this is a utopian and dangerous dream because the *other* country cannot be trusted to give up its over-rearmament policies; and their military allies, in NATO as well as in the Warsaw Pact, remain equally anxious to preserve the nuclear umbrella of their "*protector*."

Having visited together more than 90 countries, my wife and I have discovered a *universal truth* that should obviously be—but rarely is—incorporated in all textbooks about international politics: in every country, public opinion and mass media are persuaded that the danger of war comes from some other country, but never from their own. This, obviously, cannot be true.

The truth is that there exists in *every* country two types of minds:

a. Those who feel insecure, and seek their security in making sure that they are stronger than their feared opponent or opponents. But this inevitably means that the latter will feel insecure, and leads therefore to a dangerous re-armament race, or even to pre-emptive aggression.
b. Those who understand that their own security can best be guaranteed by the security of their conceivable opponents.

I hope that each of us will transmit this political message wherever he can in his own country, as more and more VIPs are increasingly prone to do today, at long last, in the USSR as well as or even more than the United States.

III ECONOMIC DIAGNOSIS AND PRESCRIPTION

I trust that this political excursion will not be regarded here as what Professor Schumpeter dubbed a "*Ricardian sin*," *i.e.* an inadmissible digression from the only field of competence of an economist: economics. Economists are also citizens and cannot

remain silent on political issues that are in fact at the root of the world economic crisis of the last 20 years, and if they wish to promote the adoption and implementation of the institutional reforms indispensable to its cure.

A. Diagnosis

The most obvious evidence of the crying need for a radical change of international economic policies and institutions is that they have not only enabled, but even pushed, the United States to incur external deficits estimated to cumulate some $571 billion over the last five years (1983-1987), and peaking at $161 billion last year.[4] Since people get so easily inured to such astronomical figures, it might be worth pointing out what this means. It means that the United States was absorbing last year from other countries far more goods and services than it exported to them, financing the difference through $160 billion of net capital imports, *i.e.*:

a) more than the *GNP (Gross National Product)* of Belgium estimated at about $142 billion;

b) about $660 per capita ($2,500 per household), which is more than the total income on which 3½ billion residents of the Third World must survive...or starve to death today.

I cannot but groan in despair when I read articles written by eminent economic colleagues eager to demonstrate that such a trend could continue for years without major financial upset, apparently delighted by this reassuring (!) perspective, and failing to note that it entails the exact opposite of common sense, *economically* as well as *humanely*: the richest, most developed, and most heavily capitalized country in the world—except for a mere handful of Persian Gulf countries—should not import, but export, capital, in order to increase productive investments in poorer, less developed, and less capitalized countries.

I have long argued that our international monetary system is at the root of this absurdity. I predicted as early as 1957 in *Europe and the Money Muddle*, and in 1959 in my testimony to the U.S. Congress, the inevitable collapse of the "*gold-exchange standard*," and pleaded for its replacement by a truly international monetary standard, based on reserve-deposits with the IMF rather than on gold, dollars, and/or any *national* currencies. The

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[4]See Table I below.

gold-exchange standard collapsed indeed *de facto* in the early 1960's, and *de jure* on August 15, 1971. But it has been replaced by what can only be dubbed a "*paper-exchange standard*," under which the U.S. dollar, even though relieved of any convertibility obligation, continues nevertheless to be accepted as the major unit of account, settlement and reserve accumulation in international contracts.

U.S. gross liabilities abroad rose, as a consequence, by about $1,300 billion over the eight years 1980-1987, from $456 billion at the end of 1979 to $1,746 billion at the end of 1987; and net exchange-market liabilities by more than $663 billion, from $15 billion to $678 billion.[5]

A crucial difference separates, however, the last five years (1983-1987) from the previous ones.[6] Up to the end of 1982, the United States reexported most (91%) of the investments received from abroad. Over the last five years, only 31% were reexported, most of them (69%) being now absorbed domestically, as noted above.

A nearly 19% average yearly increase of U.S. foreign lending in 1980-1982 and its gradual decline to less than 8% in 1983-1987 are undoubtedly the major sources of the huge 9.8% yearly rate of inflation of consumer prices for the industrial countries in 1980-1982 and of its subsequent decline to 4.1% in 1983-1987.[7]

Note, however, that the process is self-feeding throughout, and will remain self-feeding as long as foreigners continue to invest in the U.S., under the "*paper-dollar standard*," a large portion of the asset increases flowing from U.S. foreign lending. This has so far been an endless chain. But can it continue indefinitely?

The monetarist and supply-side advisers of President Reagan think it should, and welcome a prospective growth of U.S. net indebtedness to more than $1 trillion ($1000 billion) by the end of this decade.

I doubt such a prospect all the more as the private market has considerably slowed down already its investments in the U.S.

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[5]including adjustments for price and exchange-rate changes etc., totalling about $177 billion over the eight years 1980-1987, but not yet available for 1987.

[6]See Table II below.

[7]All calculated *cumulatively* from line 11 B of Table II and line 110 of the *IFS* indexes of consumer prices.

market, leaving to central banks and other foreign official institutions the burden of financing the near entirety of the U.S. deficits, without being able to prevent a steep decline of the U.S. dollar vis-à-vis its main rival currencies.[8]

The "summit meetings" of the major financial powers at the Plaza Hotel in New York, the Louvre Museum in Paris, and other palaces in Tokyo, Venice, etc. continue nevertheless to focus attention on the disorderly fluctuations of the dollar exchange-rates, rather on its major root cause, *i.e.* the inappropriate role imposed upon the dollar by the international paper-exchange standard.

B. Worldwide Monetary Prescription

My first conclusion is that statesmen should revive, at long last, the drive for fundamental monetary reforms on which an intellectual—if not political—consensus had been reached in June 1974 by Jeremy Morse's *Committee of Twenty*, after 10 years of continuous debates and negotiations of Finance Ministers, Governors of central banks, and their experts, but discarded abruptly in Jamaica and in the Second Amendment to the IMF Articles of Agreement.

One of the obstacles to these 1974 worldwide reform proposals has obviously been the reluctance of short-sighted U.S. politicians to abandon the "extravagant privilege" denounced by President de Gaulle: the possibility of financing most of the U. S. deficits through the acceptance of the *national* U.S. currency as an *international* settlements medium by foreign central banks, commercial banks and other large international investors. This, however, has to be expected: it reduces the need for unpopular tax increases or reductions of expenditures, even if this is contrary to the longer-run national interest.

I would put the major blame, therefore, on the *other* countries for being willing to extend persistently such financing to the U.S., in increasingly huge amounts, at the cost of a world inflation without precedent in man's history. But how can this be explained?

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[8]The splendid analysis of the *Report of the Deutsche Bundesbank for the Year 1987* estimates that these interventions (including $7.6 billion dollar purchases by the FECOM) financed last year 90% ($138 billion) of the revised $154 billion deficit on current account.

First of all, by bureaucratic routine, the negotiating difficulties of agreeing on an alternative world currency to be created *ex nihilo*, and the reluctance of foreign firms in competition with U.S. firms at home or abroad to abandon the advantage derived by them from the resulting overvaluation of the dollar.

Secondly because the disadvantages of such financing are confined primarily to a few countries with huge surpluses, primarily Japan and Germany. The June 1988 *OECD Economic Outlook* estimates that as much as $131 billion of the U.S. $161 billion 1987 deficit was financed by these two countries: $87 billion by Japan and $44 billion by Germany. Other countries, except the so-called NIC's (newly industrialized Asian countries), were in deficit, or had only moderate surpluses. They felt no strong interest in abandoning their overcompetitiveness vis-à-vis the United States.

Last, but far from least, the acquiescence of central banks and other official institutions to such enormous and persistent financing of U. S. external deficits in the political counterpart of their countries' dependence on the U.S. nuclear umbrella as a crucial contribution to their own defense against Soviet aggression or blackmail. Germany's military expenditures were estimated in 1986 at little more than 3% of its Gross Domestic Product, and Japan's about 1%, as against 6.7% for the United States.

U.S. defense expenditures exceeded last year $295 billion, *i.e.* about 6.6% of GNP ($4488.5 billion), and nearly twice the revised foreign deficit on current account ($154 billion) and the Federal Government's deficit ($151 billion). These overbloated expenditures are explained in official U.S. and NATO publications by highly misleading comparisons of *NATO* and *Warsaw Pact* expenditures, including in the latter for instance those of mainland China—regarded by the USSR and even by many U.S. experts as a potential enemy of the USSR rather than an ally—and excluding from the former the military expenditures of Japan, Israël, Saudi Arabia and many other countries far more likely to fight on the side of the United States than of the Soviet Union.

They should be cut down drastically in the disarmament negotiations now in process between the two superpowers. These, however, would be likely to tarry, or even fail, if they were left in

the hands of military negotiators.[9] The old observation of Clemenceau is still valid: war is too serious an affair to be left to the generals. The switch from an inflationary and lethal over-rearmament race to a *mutual* race toward disarmament should be initiated, even *unilaterally* at the start, by either of the major protagonists without endangering in any way its own security. An *MIT* (Massachusetts Institute of Technology) committee report to President Reagan concluded in June 1987, that "the superpowers could achieve their goal of deterring attacks with drastically fewer nuclear arms... since a limited attack on the United States, involving only one percent of the Soviet strategic nuclear arsenal, could set off a collapse of the U.S. economy that would last decades... The Soviet Union is even more vulnerable."[10]

Even more convincing to every statesman today—including obviously Secretary Gorbarchev—is the fact that any use of nuclear weapons would be most likely to escalate into a collective suicide of humanity.

C. Regional Monetary Prescription

Worldwide reforms are, of course, impossible without the active participation of the United States. American economists and public opinion should press their Government to alter radically the policies followed so far in this respect under the pressure of short-sighted politicians and vested private interests, and as disastrous for the United States itself as for the rest of the world.

In the meantime, pending such U. S. participation, other countries should:

1. Agree among themselves on the institutional reforms and policy commitments that will minimize, as far as possible, their present overdependence on the vagaries of U. S. monetary and fiscal policies, but also:
2. Facilitate and stimulate U. S. participation by using—as suggested by an old American slogan—both "the carrot and the stick":

   a) the "*carrot*," by couching their own reforms and policies

[9]As convincingly argued by Alva Myrdal in numerous publications.
[10]See the summary provided, on June 22nd, 1987, by our best, truly *global* newspaper: *The International Herald Tribune*.

in a manner susceptible of contributing to the solution of the U.S. dollar problem;

b) the "*stick*," by denying the U.S. the "extravagant privilege" of financing the perpetuation of U.S. policies prejudicial to all concerned.

The countries of the European Community are best able to take the leadership in such regional monetary agreements. The success of the *EMS (European Monetary System)* anchored—theoretically at least—on the ECU, rather than on the dollar or any other national currency, has exceeded all expectations and is now fully recognized by its initial opponents, particularly the Bundesbank of Germany. It must still be strengthened enormously, however, to permit the completion of the fully integrated internal market envisaged for 1992 in the *Single European Act* signed in February 1986 and ratified by all member countries in 1986 and 1987. The next section of this paper will summarize the monetary steps already agreed in this respect by important political leaders of the Community. The last section will deal with the way in which the success of a strengthened EMS would facilitate the later completion of the full economic, monetary, and therefore political union of the Community, repeatedly promised by its Heads of State and Government since the December 1969 The Hague meeting.

These institutional reforms of the Community would obviously increase stupendously its role in world economic and political relations, as may be gauged from the facts that:

1. its 1987 *gross national product* (about $4,170 billion) is now about equal to that of the United States ($4,400 billion) and nearly double that of Japan ($2,340 billion);
2. its 1987 *population* (323 million) is far larger than theirs: 245 million for the United States and 122 million for Japan;
3. its 1986 *exports*—excluding those to other EEC countries ($451 billion)—totalled $339 billion, *i.e.* over 50% more than those of the United States and 60% more than those of Japan.

Coming back briefly to the military aspects of the problem, the countries of the Community should obviously reduce their excessive dependence on the U.S. nuclear umbrella, whose actual use has become more and more doubtful—as argued by former Sec-

retary Kissinger himself—and would destroy all possibilities of life in Europe, and possibly in the world, for generations to come. Costly as it might be, a strengthening of their so-called *conventional* defense forces would be far preferable. Fortunately, it might be made unnecessary itself by the proclaimed willingness of the Gorbachev Administration to negotiate a re-equilibration of conventional armaments[11]

1. Urgent and Feasible:
The ECU as a Parallel Currency in External Transactions

1. I refer you again to two recent papers of mine[12] regarding the use of a reformed ECU—defined no longer as a basket, but as a reference currency—not only for central banks, but in all external transactions, settlements and reserve accumulation by the residents of the Community. They are framed in a way that should, I hope, answer the major political as well as economic objections which have precluded up to now general agreement on the adoption of a truly *international* currency as a practical alternative to the *national* currencies on which was anchored the "*gold-exchange standard*": primarily the pound sterling in former days, and the U.S. dollar after the second world war.

   Yet, the international collapse of the pound in September 1931, and of the dollar in 1971, have amply demonstrated the ultimate unviability of such a system. Professor Kindleberger correctly argues that the dollar has proven more acceptable than the volapük or the esperanto, but that its management should be entrusted to an enlarged open-market committee, including elected representatives of other countries. Such a proposal seems to me far more *utopian* than even the most utopian versions of the Triffin plan: no country will ever accept to have its own national currency

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[11] Note also that Helmut Schmidt, former Chancellor of Germany, has argued in numerous publications that the USSR does not enjoy today in this respect the clear superiority attributed to it by most military experts of NATO countries.

[12] "The Paper-Exchange Standard; 1971-19??" in Paul Volcker *et al.*, *International Monetary Cooperation: Essays in Honor of Henry C. Wallich*, Essays in International Finance, n°169, December 1987, Princeton University, Princeton, N.J.; and
"The IMS (International Monetary System...or Scandal?) and the EMS (European Monetary System)," *Banca Nazionale del Lavoro Quarterly Review*, n°162, September 1987, pp. 239-261.

controlled by foreigners, while they will all be not only ready, but determined, to negotiate appropriate controls over the issues of any joint reserve, or parallel currency, as demonstrated by the experience of the *International Monetary Fund* and the *European Payments Union*.

2. The two founding fathers of the *European Monetary System* and the *ECU*, Valéry Giscard d'Estaing and Helmut Schmidt, have formed a Committee designed to promote such a radical reform and to create the *European Central Bank* indispensable to the management of a European reserve currency. A "Coordination Group" of top-level official experts will finalize shortly its recommendations in this respect. Comprehensive and detailed agreements have already been reached tentatively on all essential points.

The *Bundesbank* would serve as a model for the autonomy and political independence of the *European Central Bank*. Its Board of Directors would include nine members elected by the Council of Ministers from a list submitted to it by the Board of Governors of national central banks. It would therefore have a majority representation in an Open-Market Committee of 17 members in which the other 8 members would be the governors of national central banks: 5 permanent ones would be those of the German, French, British, Italian and Spanish central banks, and 3 rotating ones those of the other central banks.[13] A Board of surveillance would include the same national bank governors as those above and, with a consultative voice only, representatives of the Commission of the Communities, the Presidency of the Council of Ministers, the Monetary Committee and the Bank for International Settlements. Finally, the European Central Bank should report periodically its agreed policy objectives to the Council of Ministers and the European Parliament.

The ECU would no longer be a currency-basket, varying with every exchange-rate realignment, but become a final "*reference currency*" vis-à-vis which every member currency's exchange rate would itself be defined. Maximum fluctuation margins would,

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[13]Alternatively, the Board of Directors would be limited to 7 members, having the same majority of one in a 13 members Open-Market Committee whose 6 other members would be the governors of the Bundesbank, the Bank of France and the Bank of England and, by rotation, those of the other central banks.

at first, be brought uniformly to 2.5%—possibly with temporary exceptions for the peseta, the escudo and the drachma—but reduced gradually to zero. The banks would, moreover, no longer charge any commissions on exchange transactions between the ECU and the national currencies of member countries. These would be costless, as they are already between the member currencies of the French franc area.

Member currencies would therefore be freely convertible, at fixed rates, among each other and with the ECU, holdings and borrowings in European currencies enabling both the national authorities and those of the Community to help finance stabilizing market interventions, not only at the agreed margins—as is already the case—but also intramarginally whenever deemed necessary or useful to avoid interventions and repayment in foreign currencies (primarily the dollar today).

Exchange-rates vis-à-vis non-member currencies would, of course, remain variable as long as the return to occasionally readjustable fixed rates, or even the acceptance and implementation of "target zones," remain well beyond the foreseeable horizon. The Committee of Governors of central banks should coordinate the size and direction of official interventions, mostly but not exclusively on the dollar market, by the European and by national central banks, instead of leaving them excessively, as is the case today, to the discretion of the Bundesbank.

The ECU should be promoted as the main—or sole?—paralel currency of the Community's authorities and residents in the denomination and settlement of international contracts and in banking and financial transactions. As far as the authorities of the Community are concerned, it should replace (a) national currencies in most contracts, receipts and expenditures and (b) the so-called "green" ECU in the common agricultural policy, through the elimination of the "monetary compensatory amounts." ECU currency notes and bank deposits should be given full liberating power, even for obligations contracted in national currencies; but the ECU itself should obviously become the most appropriate unit for European travel checks, international transport fares, postage, etc. The Bundesbank's overdue acceptance of the ECU as a legitimate currency unit in borrowing contracts will undoubt-

edly accelerate the spectacular progress of the ECU in banking and financial transactions, particularly if the current drive for the elimination of remaining exchange controls continues in France, Italy, Denmark and Belgium. I would add, however, two important qualifications in this respect:

a) Full liberalization of *intra-European* capital movements will most probably require jointly concerted policies regarding speculative capital movements between Europe and the United States, in order to avoid unbearable tensions between traditionally stronger European currencies, such as the German mark, and weaker currencies such as the French franc or Italian lira. These tensions were at the root of the last exchange-rate realignment of January 1987, for instance, caused by a flurry of capital flows toward the United States, and unjustified by any deterioration in the current account balance or purchasing power parity of the French franc.

b) Even purely intra-European capital movements may, at times be considered damaging by the recipient country where it may create inflationary pressures as well as by the capital exporting country where it may create deflationary pressures. *Jointly* agreed and implemented controls could, in this case, be far more efficacious than controls by the latter country only.

Needless to say, these ambitious proposals of the "Coordination Group" will demand appropriate controls over the issue of official and private ECUs. The Group envisages that currency notes might be issued more easily through the intermediary of the national central banks or of consortia of commercial banks, but with a 100% reserve requirement similar to that uniting Scotch banks to the Bank of England. Similarly, ECU deposits in commercial banks would be subject to 100% reserve requirements, either directly with the European Central Bank, or indirectly through their national central bank.

The European Central Bank would therefore be in full control of ECU issues, whose volume would be determined by its own loans and investments and adjusted to the currency needs of an optimal, feasible rate of non-inflationary economic growth (about

5%?). It would also control the regional distribution of its portfolio between member countries and non-member countries, particularly the United States.

The presumptive *global* ceiling on the growth of ECU issues might have to be exceeded at times, in the event of "*acts of God*" ("*force majeure*" in French) such as the two explosions of oil prices; but this should require a qualified majority of votes of two-thirds, or even more, depending on the size of the excess regarded as necessary. *National* central banks will be retained, but their role will be limited to the *implementation* of the policies adapted by the *European* Central Bank.

3. Those who equate wisdom with skepticism will, of course, dismiss as utopian the ambitious proposals just summarized. They will point out—rightly—that Ministers of Finance and Governors of central banks are prone to advocate, *when out of office*, the fundamental reforms which they consider as unfeasible when in office.

   You may be more interested, therefore, in the treaty concluded on January 20 of this year between the Governments in power in France and Germany, on the 25th anniversary of the Franco-German treaty signed in 1963 by President de Gaulle and Chancelor Adenauer. President Mitterand and Chancelor Kohl paraphed solemnly, in company with about twenty of their ministers, two additional protocols, soon to be ratified by their Parliaments and creating a *Defense and Security Council* and an *Economic and Financial Council*. An important task of the latter will be to assure a closer coordination of monetary policy between the two countries than that already in effect today, and enabling them to accept and promote the creation of a European Central Bank. The Presidents of the Bank of France and of the Bundesbank and the French and German Ministers of Finance and Ministers for Economics will make up this Council.

   The President of the Bundesbank, Dr. Otto Pöhl, expressed the agreement of the Bank's Council, but noted that—and I quote—"since the Council is to be established in the context of a treaty that is binding under international law and an examination of the legal position was not possible in

the brief period of time given to the Central Bank Council to take its decision, the agreement of the Central Bank Council is given with the reservation that the supplementary protocol does not affect the content of Sections 3 and 6 (1) and 12, sentence 2, Bundesbank Act. The Bundesbank requests the Federal Government to communicate this decision also to the French partner to the Treaty and to take it into account when ratifying the Treaty." He explained that this meant "that the freedom of decision and the independence of the Bundesbank in monetary policy affairs must not be restricted," and answered some critical remarks of Prime Minister Chirac about the Bundesbank's policies.

It is well known of course, that the Bundesbank's authorities have long been radically divided about the creation and development of the European Monetary System, to which its former President, Dr. Emminger, was adamantly opposed, as is today its Vice-President, Dr. Schlesinger. Dr. Pöhl, recently reappointed as President for a term of eight years, undoubtedly shares the German fears about "premature" commitments to the EMS, and particularly to full monetary union, until the primary objective of *price stability*, as well as exchange-rate stability, can be implemented by a better coordination of national monetary and fiscal policies, and guaranteed by the independence of a European Central Bank and its federated national central banks from undue political pressures.

Yet, he reiterates relentlessly and indefatigably in all his speeches that the ultimate goal of *full economic and monetary union, including the merging of all national currencies into a single European currency, under a European Central Bank*, must be kept in mind in the formulation of immediately feasible policies. The Basle Central Banks' agreement, ratified by the Nyborg European Council, indicates that his views are now prevailing within the Bundesbank itself, and most commentators agree that it functions in fact even better than initially hoped for by its proponents.

4. The European Parliament has also expressed repeatedly, un-

der the leadership of Lord Plumb, Otmar Franz and Fernand Herman particularly, its strong support for the measures leading to full economic and monetary union of the Community.

Equally encouraging is the totally unexpected success of the last "Brussels Summit" of mid-February regarding the financing of an increased Community budget, the doubling of subsidies to its poorest members, and the initiation, at least, of overdue radical reforms of the Common Agricultural Policy.

2. The Completion of the Economic and Monetary Union of the United States of Europe?

The completion ("parachèvement" in French) of the Economic and Monetary Union repeatedly promised by Heads of States and Governments since their first summit meeting at The Hague, in December 1969, and of the United States of Europe aimed for by the great European statesmen formally led by Monnet, de Gasperi, Spaak, etc. are still distant and uncertain.

The path toward the first is outlined in the papers referred to above, which I shall summarize very briefly in conclusion. The EMS has altered radically in this respect the transitory provisions of the 1970 Werner Plan which envisaged first the *gradual* elimination of exchange margins and exchange-rate fluctuations, before the *sudden* substitution of the ECU for the national currencies *at the end* of the process only. The EMS, on the contrary, *began* with the creation and development of the ECU as a parallel currency for external transactions, as described in the previous section of this paper. Its success would transform into ECUs the equivalent of well over $1 trillion of bank loans (and deposits) and of securities now denominated in so-called Eurocurrencies or Xeno-currencies. The completion of the monetary union would then merely require the gradual extension of the use of the ECU in domestic as well as external transactions throughout the Community. This could be done at a different pace in the various countries and is likely to proceed faster in Luxembourg, Belgium and Italy for instance, and even in Austria which has

recently indicated its desire to join the Community, than in the United Kingdom or Germany.

As an inveterate optimist, I hope to live long enough to see the end of this venture!

TABLE I

The World Network of Balances of Payments on Current Account: 1983–1987

($ billions)

Year	1983	1984	1985	1986	1987	Total
I United States	−46	−107	−116	−141	−161	−571
II Rest of the World	+46	+107	+116	+141	+161	+571
A. Industrial Countries	+24	+45	+62	+119	+108	+358
Japan	+21	+35	+49	+86	+87	+278
Germany	+4	+8	+16	+38	+44	+110
Other Countries	−1	+2	−3	−5	−23	−30
B. USSR and Eastern Countries	+11	+12	+6	+9	+8	+46
C. Non-Industrial Countries	+11	+50	+48	+13	+45	+167
1. OPEC	−22	−7	+4	−28	−4	−57
2. Others	+33	+57	+44	+41	+49	+224
reported	(−37)	(−23)	(−25)	(−9)	(+8)	(−86)
Statistical Discrepancy	(+70)	(+80)	(+69)	(+50)	(+41)	(+310)

Source: *OECD Economic Outlook*, June 1988, Table 63, p. 152; and pp. 80, 87 and 93.

Note: Line II C2 estimates are derived *residually* from "zero totals" for the world, being therefore equal to the sum of the estimates and statistical discrepancy (with reverse sign) reported by the OECD. For further explanations and qualifications, see my article on "The Paper-Exchange Standard: 1971-??" in Paul A. Volcker *et al.: International Monetary Cooperation: Essays in Honor of Henry C. Wallich* (Essays in International Finance, N°169, December 1987, Princeton, N.J.) pp. 72-73, and particularly footnote (a) of Table I, on page 73.

TABLE II

International Balance Sheet of the United States: 1969–1987

($ billions)

	End of Year				Total Changes			Average Yearly Change			
I Exchange Market	1969	1979	1982	1987	1970-79	1980-82	1983-87	1970-79	1980-82	1983-87	1987
A. **Liabilities** (−)	−103	−456	−809	−1,746	−353	−353	−938	−35	−118	−188	−214
1. Official	−19	−160	−189	−283	−141	−29	−94	−14	−10	−19	−41
2. Banks	−30	−125	−254	−618	−95	−130	−364	−9	−43	−73	−75
3. Customers	−54	−171	−366	−845	−117	−194	−480	−12	−65	−96	−98
a) Statistical Discrepancy	(−3)	(−39)	(−121)	(−210)	(−36)	(−81)	(−90)	(−4)	(−27)	(−18)	(−18)
b) Recorded	(−51)	(−132)	(−245)	(−635)	(−81)	(−113)	(−390)	(−8)	(−38)	(−78)	(−79)
B. **Assets**	114	441	739	1,068	+327	+298	+329	+33	+99	+66	+98
1. Official	5	8	23	35	+3	+15	+12	–	+5	+2	−3
2. Banks	13	157	405	548	+144	+248	+143	+14	+83	+29	+41
3. Customers	96	276	312	486	+180	+36	+174	+18	+12	+35	+60
C. **Net Assets**	+12	−15	−69	−678	−26	−55	−609	−3	−18	−122	−116
1. Official	−14	−152	−166	−248	−138	−14	−82	−14	−5	−16	−44
2. Banks	−17	+32	+151	−70	+49	+118	−221	+5	+39	−44	−34
3. Customers	+42	+105	−54	−360	+63	−159	−306	+6	−53	−61	−38
II **Gold and Foreign Aid**	42	194	195	215	+152	+1	+20	+15	–	+4	+23
1. Gold, at market price	12	135	121	127	+124	−15	+6	+12	−5	+1	+25
2. Net Foreign Aid Claims	30	58	75	88	+28	+16	+14	+3	+5	+3	−1
III **Total, Net** (= IC + II)	+54	+179	+126	−463	+126	−53	−588	+13	−18	−118	−93
1. Assets (= IB + II)	156	635	934	1,284	+479	+300	+349	+48	+100	+70	+121
2. Liabilities (= IA)	−103	−456	−809	−1,746	−353	−353	−938	−35	−118	−188	−214

TABLE II (cont.)

International Balance Sheet of the United States: 1969–1987

($ billions)

	End of Year				Total Changes			Average Yearly Change			
Memo: IV **Net Assets reported in Survey Tables**	+57	+94	+137	−368	+38	+42	−505	+4	+14	−101	−99
Difference: III − IV = 1 + 2	−3	+85	−11	−94	+88	−95	−83	+9	−32	−17	+6
1. Unrecorded Gold Appreciation	–	+124	+109	+116	+124	−15	+8	+12	−5	+2	+25
2. Statistical Discrepancy	−3	−39	−121	−210	−36	−81	−90	−4	−27	−18	−18

Sources: 1. "International Investment Position of the United States," Table 2 of *Survey of Current Business*, June 1988 and corresponding Table in previous issues;

2. *plus* corrections:
   a) unrecorded appreciation of official gold holdings at market price (amounting at the end of 1987 to 11½ times their irrelevant official valuation at the latest official price of $42.223 per ounce reflecting its 10% devaluation (from $38 per ounce) on February 12, 1973);
   b) the "statistical discrepancy" (errors and omissions) repeatedly ascribed in the text of accompanying articles of the *Survey* (and of the *Federal Reserve Bulletin*) as probably due mainly to unrecorded capital transactions, and included as such until 1900 in official U.S. estimates.

Notes: 1. Exchange Market estimates are designed to show *capital* assets and liabilities and exclude therefore:
   a) gold holdings, shown on line II, 1: and
   b) foreign aid claims, shown on line II, 2, because they could not be used to defend dollar exchange rates on world markets since they are 99% *long-term* assets and more akin to grants than to loans, being usually rolled over or canceled, but rarely cashed at maturity.

2. Gross liabilities (line I A) are shown first because they are the source of the capital assets (line II B) accumulated by the United States in spite of its growing deficits on current account.

3. Line 1 A2 estimates include both the liabilities of commercial banks and Treasury securities held abroad by the private sector (mostly by banks). This total formerly known as "dollar balances" reflects essentially the use of the dollar as a world parallel currency rather than as earning investments.

4. The years 1969, 1979 and 1982 were selected as most indicative of major changes in the evolution of important categories of accounts.

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