The Continuing International Monetary Crisis: A British Columbia Perspective

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This paper is concerned with international monetary reform, that is reform of the international arrangements under which the monetary systems of individual countries are linked together. The perspective of the paper is that of a British Columbian, but the problem itself is clearly international rather than regional or national in scope. This is not a problem about which we can expect the Canadian government, unilaterally, to "do something." Solutions require international negotiations leading to international agreements, and Canada is but one of a large number of nations which will eventually make the decisions.[1] Nonetheless, we do have the right to expect the Canadian government to take a strong, constructive position, and to press its views vigourously in international negotiations.

[1] It is interesting to ask: what is the relevant decision-making group? The constitution of the international monetary system is embodied in the Articles of Agreement of the International Monetary Fund (IMF), as agreed upon at the United Nations Monetary and Financial Conference held at Bretton Woods, New Hampshire, in 1944. Only the membership of the IMF can amend the Articles of Agreement, although wide scope is given to the Fund's executive directors to make decisions of fundamental importance.

At present, there are 118 members of the IMF, an unwieldy group at best. Six of the major members have their own executive directors. The remaining 112 members are assigned to 14 groups, each with an executive director elected by the group. The assignment of countries to groups, together with the system of voting (weighted by the size of the country's quota in the Fund), ensures that most of the major industrial nations are represented directly on the executive board.

Members of the IMF have sharply divergent interests in international financial affairs. One of the sharpest divisions is that between rich and poor: between the highly industrialized nations and the less developed nations. Ninety-two of the 118 members of the Fund are classified as less developed nations by the IMF. Nine of the 20 executive directors come from this group. Together they cast about 30 per cent of the votes.

Perhaps because of its unwieldy size, and perhaps because of the sharply divergent interests within the group, the major initiatives toward international monetary reform in recent years have been taken outside this broad international forum. The crucial institution has been the "Group of Ten," which is actually a group of eleven. It includes ten industrialized members of the IMF, and Switzerland, a non-member. Canada is one of the ten. All members of the Group of Ten, except Switzerland (of course) and Sweden are also executive directors of the IMF. Together they have 57 per cent of the votes.

The negotiations following the American balance of payments crisis suggest that the Group of Ten rather than the IMF has become the relevant decision making body. In any case, the Group of Ten is in a position to dominate the IMF.

BC STUDIES, no. 13, Spring 1972

My purpose is to suggest, from the point of view of British Columbia, what I think that position should be, and to argue the urgency of proceeding immediately with the indicated reforms.

I am using the expression "international monetary crisis" in a very broad sense. I am not simply concerned with the recent American balance-of-payments crisis or the international financial repercussions of the policy measures adopted to cope with the immediate and urgent problems which that episode posed. Although the events of 1971 play an important role in my analysis, my basic concern is with an aspect of the *constitution* of the international financial system. I will argue that the existing system has a fundamental constitutional flaw, the correction of which is a matter of vital importance for the health of the international economy. The recent American crisis must not be seen in isolation as a peculiar 1971 American problem, which has now been solved, but rather as another particularly severe and central manifestation of the flaw with which the international monetary system has functioned, increasingly uncomfortably, since 1958. We have tried systematically to suppress the most severe manifestations of the underlying problem, with varying degrees of short-term success. The agreements reached to resolve the American crisis of 1971 suggest that we will attempt to do this again. Rather than taking the occasion to initiate a fundamental reform, we have again attempted to patch up the existing system. But, like the rubber of a much-patched, well-used, old inner tube, the deteriorating fabric of the international monetary system will not support many more patches. A serious risk of collapse remains.

That the international financial system is not in good condition is widely recognized. Its ills have been variously diagnosed, and a multitude of reforms have been proposed which vary in radicalism and complexity.[2] However, it is most commonly argued that the fundamental problem is a deficiency in the growth and perhaps the international distribution of something called international "liquidity." Indeed, if there is an "official" interpretation of the constitutional problem, that is it. I will argue, however, that emphasis on international liquidity is misplaced. An alternative interpretation is much more fundamental. The basic problem is not the provision of more international liquidity within the framework of existing

[2] R. G. Hawkins, *Compendium of Plans for International Monetary Reform,* The Bulletin, C. J. Devine Institute of Finance, No. 37-38 (December 1965); F. Machlup, *Plans for Reform of the International Monetary System,* International Finance Section, Princeton University, Special Papers in International Economics, No. 3 (August 1962).

international arrangements, but rather the provision of a new, sensitive mechanism for international *adjustment.*[3]

Simply stated, the objective of those who focus on international liquidity is to develop a mechanism which will provide national governments with sufficient financial resources to enable them to withstand temporary balance-of-payments deficits without resort to direct controls over international trade and payments or unacceptable restraints on their domestic economies, and, in the face of more fundamental balance-of-payments problems, to have time to consider and implement longer-term corrective policies (including devaluation) in consultation with trading partners and international agencies. Multilateral consultation, co-operation and surveillance are the watchwords. By contrast, the objective of those who focus on international adjustment is to develop a mechanism by which the immediate causes of balance of payments deficits can be eliminated or neutralized smoothly, sensitively and quickly, with minimal disruptions to domestic economic activity and international trade and finance. What is sought is a mechanism by which national economies, in which national governments are pursuing economic policies in their own national interest, can be adjusted to each other so that their international payments balance more or less automatically, and continuously. The ideal would be a situation in which only transitory balance of payments deficits would ever arise, thus minimizing official requirements for international liquidity.

What is British Columbia's interest in such ethereal issues? Like Canada among nations, British Columbia among regions has a much-above-average dependence on international trade and investment. I will argue that failure to evolve a rational mechanism for international adjustment will lead to increasingly severe restraints on international commerce and finance. We cannot help be among the largest losers in such developments. As a province, we have a very high stake in international monetary reform.

The broad outlines of the American balance of payments situation in recent years are familiar. A long succession of balance of payments deficits, stretching back to the late 1950's, involved a steady drain on American official reserves of gold. These drains were aggravated from time to time by official sales in the private London gold market to maintain the

[3] My main theme is far from original. Nonetheless, the argument seems to be little understood, and its significance little appreciated. For an alternative view of the relationship between international liquidity and the adjustment process, see: R. N. Cooper, "International Liquidity and Balance of Payments Adjustment," in *International Reserves: Needs and Availability* (Washington, International Monetary Fund, 1970). 125-145.

can be adjusted from time to time, but only in the face of a "fundamental disequilibrium" in the balance of international payments. Thus, the system has come to be known as the "adjustable peg" system. However, the second major principle of Bretton Woods is that adjustments in par values are matters of international concern, not to be proceeded with unilaterally, but only after consultation with and approval by the international community through the medium of the executive directors of the International Monetary Fund. Multilateral surveillance is supposed to prevent the use of the exchange rate as an instrument of selfish, nationalistic economic policy.

The third key principle is that of free inter-convertibility of currencies, for normal commercial purposes, at prices within the prescribed band about official par. This means foreign exchange markets devoid of all controls which might interfere with international trade in goods and services.

It is interesting to note that the rules only require free inter-convertibility of currencies for current-account and closely-related capital-account transactions. Other types of international capital flows could be controlled. Indeed, the original agreement seemed almost to require members of the system to invoke direct controls to prevent destabilizing international speculative capital transfers. Many, but not all, countries have significant controls over international capital transfers. However, such controls have proved to be very leaky. Not all capital transfers are effectively controlled; and international speculation has certainly not been eliminated. Indeed, it is now widely recognized that it is almost impossible to have tight capital-account controls without also controlling current-account transactions, which is against the rules.

In order to make this system of fixed exchange rates and virtually free foreign exchange markets viable in an ever-changing world economy, national governments must have access to very large quantities of convertible foreign exchange which can be used to finance intervention in the foreign exchange market in support of their currency whenever the market will not clear at the official exchange rate. To this end, the Bretton Woods system provides for a pooling of foreign exchange reserves through the International Monetary Fund, with each member in good standing having access to the pool of reserves as necessary. The resources of the Fund have been expanded since 1946 through the addition of new members and through three across-the-board increases in subscriptions to the Fund (1959, 1966 and 1970), and they have been supplemented by other borrowing-lending arrangements both within the framework of the I.M.F., and outside it.

Finally, it is important to remember that the Bretton Woods system has a golden base. Although not actively used for international payments or foreign exchange market intervention, gold is the standard international money for the system. All members were supposed to declare par values for their currencies in terms of gold, and had the choice of agreeing to intervene in the foreign exchange market to ensure stability of the market exchange rate at or near the official par rate, or guaranteeing official convertibility of their currency into gold at the agreed fixed price. Only the United States chose the latter option, but so doing it established a firm and crucial link between the international monetary system and the gold stock.

In broad outline, that is the Bretton Woods System.

The ills of the Bretton Woods system are commonly diagnosed as a "liquidity" problem. The flaw in the system is said to be the lack of a

TABLE I

MAGNITUDE AND DISTRIBUTION OF OFFICIAL INTERNATIONAL MONETARY RESERVES, 1960-1970

(billions of $U.S.)

	(1) *1960*	*(2)* *1965*	*(3)* *1970*
	Total Reserves		
All Members of the International Monetary Fund	60.3	70.5	92.4
	Distribution of Reserves		
U.S.A.: Total Reserves	19.4	15.5	14.5
Gold	17.8	14.1	11.1
Convertible Currencies	—	0.8	0.6
IMF Position	1.6	0.6	1.9
Special Drawing Rights	—	—	0.9
Other Members: Total Reserves	40.9	55.1	77.9
Gold	20.2	27.8	26.1
Convertible Currencies	18.7	22.5	43.8
IMF Position	2.0	4.8	5.7
Special Drawing Rights	—	—	2.3

SOURCE: International Monetary Fund, *International Financial Statistics*, Vol. XXIV, (December 1971).

fixed price of gold in the face of intense speculative pressures. Thus, in the ten years from 1957 through 1967, American gold reserves fell by more than half, from $22.9 billion to $10.9 billion. A temporary respite occurred in 1968 and 1969, supported by an international agreement to suspend official support for the price of gold in the London gold market and partial demonitization of gold internationally. However, in late 1970 and early 1971 the American balance of payments problem reasserted itself. From a small surplus in 1969, the balance of payments shifted to a deficit of almost $10 billion in 1970. In the first half of 1971 the deficit more than doubled, to an annual rate of $22 billion. From 1960 through 1969 the annual deficit had never exceeded $3.5 billion.[4]

Deficits of this magnitude could not be sustained. Corrective action was both necessary and urgent. The American government's response was the familiar policy proposals of August 15 — a combination of measures for domestic economic expansion, restrictions on imports to the United States, implicit export subsidies, suspension of the convertability of the United States dollar into gold, and a round of international negotiations to realign exchange rates and reduce other countries' restrictions on American exports. Shock waves rebounded around the world.

The crisis of 1971 is undoubtedly one of the most important episodes in the post-World War II history of the international financial system. In terms of international financial repercussions alone, it has been unequalled since the British abandonement of gold in 1931 or the American devaluation of 1933. In terms of its impact on international financial policies, it may eventually prove to have had a more profound effect than any single development since the Bretton Woods agreement of 1944.

In spite of all of this, the crisis of 1971 should be seen as but the latest of a long series of crises which have racked the present international financial system since it was effectively established in 1958. Remember the seemingly continuous — or at least repetitive — crises of the pound sterling in the 1960's, climaxing in the devaluation of 1967; the major crisis of the Canadian dollar in 1960-62 (the Coyne and post-Coyne episodes) and the subsequent mini-crises associated with uncertainties about the impact of new American policies (such as the interest equalization tax in 1963 and the guidelines respecting capital exports in early 1968); the German and Swiss struggles to cope with almost continuous large scale inflows of foreign funds, involving two revaluations of the

[4] The measure of the balance of payments deficit cited here is what is called the "official settlements balance." Alternate measures of the balance of payments reveal the same pattern. Cf., *U.S. Balance of Payments Trends, Period ending: 3rd Quarter 1971* (Federal Reserve Bank of St. Louis, January 1972).

mark during the 1960's and special policy measures in both countries to discourage capital inflows (crises with a difference!); the crisis of the French franc, culminating in the devaluation of 1969; and the repetitive crises in the international gold market, leading up to the great gold rush of 1967-68 and climaxing in the major change in gold trading arrangements and in the monetary functions of gold in 1968.[5] This list is far from exhaustive. In addition to the crises of the currencies of other major trading nations, it systematically omits the problems of the currencies of all other nations not in the industrialized core of the western world's economy.

This historical record is rather discouraging. The Bretton Woods conference of 1944 established a set of international institutions which were supposed to ensure international co-operation, harmony and stability in international financial affairs. The Bretton Woods system became fully operative in 1958 or 1959, by which time most major currencies were freely inter-convertible for most purposes. Yet, since then, crisis rather than tranquility has been the order of the day. Moreover, while I have not developed an index of the frequency and intensity of international financial crises, I suspect that both have increased rather than waned as the Bretton Woods system has developed and matured.

This record suggests that there is a fatal flaw in the Bretton Woods System. In the long-run the system is unworkable because it provides short-term palliatives for immediate symptoms rather than cures for the underlying ailments.

What is the Bretton Woods system which I say is unworkable?

For our purposes it is not necessary to summarize all of the institutions of the present international monetary system. It is sufficient to summarize the basic principles of its constitution, the Articles of Agreement of the International Monetary Fund, as agreed upon at the United Nations Monetary and Financial Conference held at Bretton Woods, New Hampshire, in 1944.

The key principles are three-fold. The first is stability of international exchange rates. Every currency should have a par value, in terms of gold or some key currency which is convertible into gold, and day-to-day fluctuations of the market exchange rate around the official par rate should be narrowly confined. Originally the magic band was to be one per cent on either side of par.

Stability does not imply absolute and irrevocable fixity. Exchange rates

[5] An excellent, and readable, survey of the recent turmoil in the international financial system is provided in Fred Hirsch, *Money International* (London: Penguin Press, 1969).

TABLE II

I.M.F. AGGREGATE QUOTAS AND OFFICIAL INTER-GOVERNMENTAL CREDIT FACILITIES, 1961-1970

(billions of $U.S.)

	(1) 1961	(2) 1965	(3) 1970
International Monetary Fund: Aggregate Quotas	15.0	15.9	28.8
Other Credit Facilities			
General Arrangements to Borrow	—	6.0	6.0
Federal Reserve System Swap Network	0.6	2.8	11.2
Ad Hoc Credit Facilities	1.1	1.9	4.7
Total: Other Credit Facilities	1.7	10.7	21.9

SOURCE: International Monetary Fund, *1971 Annual Report.*

mechanism for the creation of international liquidity when required and in the volume required to underwrite the stability of the system. Many experts argue that inadequate provision for the growth of the supply of international liquidity has, actually or potentially, put the international economy in a straight jacket, just as inadequate growth of the money supply would put a domestic economy in a straight jacket.

What these experts mean by international liquidity is not always clear. However, they usually seem to have in mind a narrow concept of official international monetary reserves, i.e., the actual stock of internationally acceptable money in the hands of national governments and central banks which is available to make international settlements. This includes gold, convertible currencies (particularly U.S. dollars, the usual currency for intervention in the foreign exchange market), and automatic drawing rights to the pool of gold and convertible currencies in the International Monetary Fund.

It is true that the formal institutions of the Bretton Woods system do not include a mechanism for systematically augmenting the aggregate stock of international monetary reserves, at least until the recent experimental implementation of the special drawing rights plan. Nonetheless, the growth of such reserves has not been negligible, as is shown in Table I. Between 1960 and 1970, the reserves of all members of the International

Monetary Fund increased by about $30 billion, or 50 per cent. Moreover, as is indicated in Table II, actual holdings of foreign exchange have been bolstered by the development of large-scale, inter-governmental lines of credit, which could be drawn upon in times of emergency.[6]

Table I also reveals two highly significant features of the creation of international reserves in this period. First, while the reserves of the rest of the world increased, the reserves of the United States continuously fell. Of particular significance was the redistribution of gold from the United States to the rest of the world. Gold remained the basic international money, and most countries showed a preference to keep some of their reserves in gold. But the United States was the only country with a formal commitment to convert its currency into gold, at a fixed price, on demand for other governments.

The second point to note is that well over half of the increase in the reserves of countries other than the United States was in convertible currencies, which is to say, by and large, United States dollars. The American balance of payments deficit was a primary vehicle through which the rest of the world was supplied with international reserves. But, as American liquid liabilities thus increased, and American gold reserves shrank, the American commitment to convert dollars in foreign official hands to gold became less and less credible.

Clearly, the link to gold, through the intermediary of the United States dollar, was not a viable arrangement in the long run. The process by which international reserves were created in this period did have a serious structural flaw, and that flaw helps explain why gold and United States dollars were interacting focii for speculative activities. It is also obvious why the crisis of the American dollar should have such extensive reper-

[6] The terms in Table II need some explanation. The top line is the aggregate of all quotas of all members in the International Monetary Fund. This is a very crude index of the total lending power of the Fund — crude, because not all currencies held by the Fund will be useful at any point in time. The General Arrangement to borrow is an agreement among the Group of Ten to lend funds to the IMF, when necessary, so that the Fund can in turn lend these funds to members of the Group of Ten whose currencies may be under pressure in the foreign exchange market. The amount indicated is the aggregate sum potentially available under the agreements, including what had been drawn to that date. The Federal Reserve Swap network is a complex set of agreements between the Federal Reserve System and other central banks to make funds available in emergencies. Again, the sum indicated is the amount potentially available, including what had been drawn to that date. What I have called "ad hoc credit facilities" represents sums made available through specific inter-central bank agreements to deal with specific emergencies. They do not involve long standing arrangements. The sum indicated thus does not indicate what might be potentially available in other emergencies. For a discussion of these matters, see Hirsch, *op. cit.*, 305-386.

cussions. However, I will argue that serious as it was, the gold link was not the *fundamental* flaw of the Bretton Woods system.

Granted the problems inherent in the link to gold, the question remains whether the growth of international liquidity has been in some sense inadequate in recent years.

We cannot assess the adequacy of the growth of international liquidity without some knowledge of the growth of the demand for reserves, something about which we know very little. However, if the overall growth of reserves had been seriously and persistently inadequate relative to the growth of demand for reserves, we would presumably have observed *many* governments simultaneously pursuing policies to increase their reserves. In the absence of restrictions over trade and capital exports, this would have meant generally deflationary policies in most countries. Given the behaviour of price levels, this does not seem like a plausible interpretation of recent history!

What we have observed instead was a *sequence* of countries with temporary, but severe, international liquidity problems, while the overall growth of aggregate international reserves was probably, in some sense, adequate. The most dramatic problems were those which found a country with inadequate reserves to defend a currency under speculative attack. We should not forget, however, that occasionally governments were embarrassed by an excessive inflow of funds with which they could not easily cope.

To say that such problems reflect inadequate growth in international liquidity is much like blaming the impending bankruptcy of a mismanaged firm on the behaviour of the aggregate money supply. No reasonable behaviour of the money supply would have prevented that particular firm from getting out of line with its competitors. If it is to be saved, some method must be found to adjust the firm to market realities. Similarly, I argue, the hypothesis that inadequate growth of international liquidity is at the root of the international monetary problem misses the essential point. What is lacking is an effective method to adjust national economies to changing international market realities.

To see why I make this assertion, consider briefly the anatomy of a typical foreign exchange crisis (of the British type, not the German).

Over some period of time, something happens to disturb the normal economic relationships between the country in question and its major trading partners. The disturbance might be differential inflationary pressures; changes in output capabilities; or pressures from competitive suppliers. Indeed, actual developments are not necessary. The threat of a

major policy shift may be sufficient, as has been illustrated in the Canadian case several times.

The important point is that at the pre-existing official exchange rate, there are now grounds for doubting that international payments flows will balance. There are grounds for doubting that the exchange rate can be maintained.

International speculators now enter the picture. We should note that these men are not exclusively shifty-eyed little gnomes in back rooms with international telephone connections, but include the treasurers of most large international trading firms anxious to protect their legitimate commercial interest in the face of a possible change in the exchange rate, not to mention international tourists, investors and "ordinary citizens." As more of us gain experience with the international financial system, the range of potential international speculators widens.

As has been pointed out many times, speculation in this context is a one-sided gamble. The currency will either be devalued, or it will not. There is no chance that the currency will be appreciated. Since it is thus virtually riskless, the movement of funds in response to an expected devaluation can be massive indeed. Moreover, the more massive the speculative movement, the more likely that the devaluation will actually occur, for the government will be increasingly hard pressed to maintain the exchange rate. Speculation will breed speculation. At the height of recent speculative orgies the newspapers were full of stories of billions of dollars crossing national boundaries in a matter of days.

Within the rules of the Bretton Woods game, there is no defence against such speculative attacks, unless the government resorts to direct controls. The government is required to do what is necessary to maintain the official exchange rate until it can be demonstrated that what exists is a fundamental disequilibrium. But that is an ill defined concept. In effect, speculators are speculating that a fundamental disequilibrium exists: the government is speculating that it does not. And the larger the government's speculative commitment becomes, the more reluctant it becomes to admit that it was wrong. Unfortunately, the government has another weapon: it can take measures to correct the balance of payments situation through internal deflation or restraints on imports and capital exports. Time and time again, the protection of the exchange rate — or of the government's speculative position has become the ultimate objective of policy with the result that not only is the domestic economy penalized through deflation, but one of the basic rules of the Bretton Woods system

is violated through implicit or explicit controls on international trade and investment.

It can also be argued that the Bretton Woods system involves an inequitable distribution of the burdens of balance of payments adjustment. Balance of payments imbalances are two-sided. One country's deficit is some other countries' surplus. Regardless of the causes of the maladjustment in trading relations, the country with the deficit is expected to rein-in its domestic economy, creating deflationary pressures and probably unemployment. On the other side, the countries with balance of payments surpluses are not expected to contribute to the adjustment process through vigorous internal inflation.

This analysis suggests that the inflexibility of exchange rates is central to contemporary international monetary crises. In the event of inevitable dislocations in relations among national economies, a pegged exchange rate becomes a dam behind which massive speculative pressures accumulate. The resulting crisis is usually resolved through a combination of deflationary policies in the deficit country and restrictions on international trade and finance. Maladjustments in economic relationships among countries are inevitable in a dynamic world. What is urgently required is a method for resolving these maladjustments, quickly and smoothly, before they develop into crises: not a mechanism for coping with, and eventually resolving, crises.

The obvious solution is to allow exchange rates to adjust, automatically and sensitively, in response to shifts in the balance of international payments. Not only would this tend to initiate immediately corrective adjustments in international trade and capital flows, but also it would eliminate the common basis for massive international speculation. Indeed, flexibility of the exchange rate would permit international speculators to perform their legitimate economic function. Anticipating necessary changes in exchange rates, their speculative activities would facilitate smooth adjustment to the new level, and in the process eliminate the basis for further speculative activities.

In short, my arguments point to the desireability of a universal system of flexible exchange rates, in the interests of avoiding unnecessary foreign exchange crises and associated unfortunate restraints on international trade and investment and economic activity.

That the flexibility of exchange would create possibilities for serious abuse through direct manipulation of exchange rates cannot be denied. As under the Bretton Woods system, constitutional rules would be essential, as would be multilateral surveillance and enforcement of the rules.

Particular attention would have to be paid to the behaviour of official foreign exchange reserves to ensure that they are not used to induce movements in exchange rates — what has come to be called a "dirty" float. However, in principle, surveillance of exchange reserve policies should be no more difficult that surveillance of exchange rate policies.

The 1971 crisis provided an opportunity for fundamental reform of the international monetary system. To date, this is another opportunity missed. Contrary to the views expressed in the news media, the outcome of the American balance of payments crisis is not a fundamental reform but another attempt to patch-up the Bretton Woods system. The achievement of the Washington conference was the relief of a crisis, not fundamental international monetary reform.

In brief, the terms of the Washington agreement are as follows. The United States agreed to remove the restrictions on imports imposed on August 15, including the discriminatory features of domestic tax changes proposed at that time, in exchange for a general realignment of exchange rates. As part of the realignment of exchange rates the United States agreed to raise the price of gold by about eight per cent, although it is not clear whether the United States will reestablish its traditional policy of convertability of the dollar to gold at the new price. Finally, it was agreed that the width of the acceptable band for exchange rate fluctuations about par should be doubled, and that, because of its "exceptional circumstances," the Canadian dollar should be allowed to continue to float.

There are some hopeful elements in this agreement.[7] It is possible, although far from certain, that the inflexible link to gold may have been broken — or better, not reestablished, since it was broken unilaterally by the Americans on August 15. There is also the suggestion that greater flexibility of exchange rates is not out of the question. However, the agreement stopped far short of endorsement of the principle of universal flexible exchange rates. Adjustable par rates remain: with the same potential for provoking speculation when any exchange rate presses against its upper or lower limit. Unless something more fundamental is agreed upon in the meantime, it seems inevitable that there will be another serious foreign exchange crisis within the next year or so. Which country will it

[7] There are also some disturbing features to the resolution of the crisis. In many ways, the whole affair was subversive — perhaps decisively so — of the role of the IMF in the international financial system. Rather than multilateral consultation and cooperation in solving the problem, the American government resorted to crude power politics. The agreements which resolved the crisis, were made in the Group of Ten, and then reported to the IMF as a *fait accompli*. It is doubtful that the IMF can again assert itself as the policeman of the international monetary system, whether under the Bretton Woods rules or under some new set of rules.

be? What will be the impact on British Columbia's exports and the British Columbia economy?

Many British Columbia businessmen are — I think justifiably — distressed with the behaviour of Canada's floating dollar over the past year and a half. They may find my advocacy of even more general flexibility of exchange rates somewhat perplexing. If one flexible rate is bad, will not many flexible rates be positively evil?

First, we must distinguish between problems which arise because of the level of the foreign exchange rate, and problems which arise because the rate is flexible, subject to movements upward and downward. I sympathize with the view that since the freeing of the exchange rate on June 1, 1970, the rate on the Canadian dollar has been inappropriate for the British Columbia economy. Unemployment in British Columbia has been unacceptably high. The stimulation to exports which would result from a depreciation of the Canadian dollar would seem more appropriate to our circumstances than the restrictive effects of appreciation. However, that is an argument about the *level* of the foreign exchange rate, at a particular time and in a particular economic situation. Indeed, it is more precisely an argument about domestic fiscal and monetary policies — an argument that these policies were insufficiently expansionary in light of the unemployment situation. The freedom given to the federal government by the flexibility of the exchange rate to pursue more vigourously expansionary measures was not exploited. However, we cannot blame the inadequacies of policy on the flexibility of the exchange rate.

More serious, to my mind, is the concern that the development of export industries will be hampered if there is uncertainty about exchange rates. It can be argued that export businesses can only make rational investment decisions if they can depend with some certainty on the level of the exchange rate.

However, I find even this argument far from persuasive. What the present system does is not eliminate the relevant uncertainty, but transform it — and perhaps through the stimulation of speculation it may actually aggravate uncertainty. Major changes in exchange rates through the life of any given investment project are not ruled out. That uncertainty persists. More seriously, attempts to maintain inappropriate exchange rates can lead governments to implement policies which have an even more devastating effect on export markets than appropriate adjustments of exchange rates. Potential uncertainty about exchange rates is transformed into uncertainty of access to export markets.

In the long run, if the present system is continued, there is a serious risk

that important export markets will be gradually but firmly closed. Trade restrictions imposed to deal with speculative crises may long outlast the crises. The liberalizing trends in international trade policies since World War II may be reversed.

There are important economic advantages to British Columbia from maintaining the momentum toward the liberalization of international trade policies in the western world.[8] Continued liberalization is only possible if we can find an efficient mechanism for international adjustment. There are obvious risks to a regime of flexible exchange rates. There are uncertainties to be calculated and coped with: and there are potential abuses to be identified and avoided. However, universal flexibility of exchange rates promises greater chances of success than a patched-up Bretton Woods system. I would argue that the risks are well worth taking.

[8] R. A. Shearer, J. H. Young and G. R. Munro, *Trade Liberalization and a Regional Economy: Studies of the Impact of Free Trade on British Columbia* (Toronto: University of Toronto Press for the Private Planning Association of Canada, 1971).