Text of Shultz Talk Before International Monetary Fund and World Bank
Special to The New York Times
New York Times (1857-Current file); Sep 27, 1972; ProQuest Historical Newspapers The New York Times (1851 - 2005)
pg. 70

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WASHINGTON, Sept. 26—Following is the text of a statement by Secretary of the Treasury George P. Shultz today at the annual meeting of the International Monetary Fund and the World Bank:

The nations gathered here have it in their power to strike a new balance in international economic affairs.

The new balance of which I speak does not confine itself to the concepts of a balance of trade or a balance of payments.

The world needs a new balance between flexibility and stability in its basic approach to doing business.

The world needs a new balance between a unity of purpose and a diversity of execution that will permit nations to cooperate closely without losing their individuality or sovereignty.

We lack that balance today. Success in the negotiations in which we are engaged will be measured in terms of how well we are able to achieve that balance in the future.

Harmony Is Sought

I anticipate working closely and intensively with you to that end, shaping and reshaping the best of our thinking as we proceed in full recognition that the legitimate requirements of each nation must be meshed into a harmonious whole.

In that spirit, President Nixon has asked me to put certain ideas before you.

In so doing, I must necessarily concentrate my remarks today on monetary matters. However, I am deeply conscious that, in approaching this great task of monetary reform, we cannot neglect the needs of economic development. I am also conscious that the success of our development efforts will ultimately rest, in large measure, on our ability to achieve and maintain a monetary and trading environment in which all nations can prosper and profit from the flows of goods, services and investment among us.

Committee of 20

The formation of the Committee of 20, representing the entire membership of the fund, properly reflects and symbolizes the fact that we are dealing with issues of deep interest to all members, and in particular that the concerns of developing countries will be fully reflected in discussions of the reform of the monetary system.

As we enter into negotiations in that group, we have before us the useful report of the executive directors, identifying and clarifying some of the basic issues which need to be resolved.

We also look forward to participation by other international organizations, with each contributing where it is most qualified to help. The challenge before us calls for substantial modification of the institutions and practices over the entire range of international economic cooperation.

There have already been stimulating contributions to our thinking from a wide variety of other sources—public and private. I have examined with particular care the statements made over the past few months by other governors individually and the eight points which emerged from the deliberations of the finance ministers of the European Community.

Underlying Principles

Drawing from this interchange of views, and building upon the Smithsonian Agreement, we can now seek a firm consensus for new monetary arrangements that will serve us all in the decades ahead. Indeed, I believe certain principles underlying monetary reform already command widespread support.

First is our mutual interest in encouraging freer trade in goods and services and the flow of capital to the places where it can contribute most to economic growth. We must avoid a break-up of the world into antagonistic blocs. We must not seek a refuge from our problems behind walls of protectionism.

The pursuit of the common welfare through more open trade is threatened by an ancient and recurring fallacy. Surpluses in payments are too often regarded as a symbol of success and of good management, rather than as a measure of the goods and services provided from a nation's output without current return.

We must recognize, of course, that freer trade must be reconciled with the need for each country to avoid abrupt change involving serious disruptions of production and employment. We must aim to expand productive employment in all countries—and not at one another's expense.

A second fundamental is the need to develop a common code of conduct to protect and strengthen the fabric of a free and open international economic order.

Such basic rules as "no competitive devaluation" and "most-favored-nation treatment" have served us well, but they and others need to be reaffirmed, supplemented and made applicable to today's conditions. Without such rules to guide us, close and fruitful cooperation on a day-to-day basis would not be possible.

Third, in shaping these rules we must recognize the need for clear disciplines and standards of behavior to guide the international adjustment process — a crucial gap in the Bretton Woods system. Amid the debate about the contributing causes of past imbalances and the responsibility for initiative toward correction, sight has too often been lost of the fact that adjustment is inherently a two-sided process — that for the world as a whole, every surplus is matched by a deficit.

Symmetry Is Essential

Resistance of surplus countries to loss of their surpluses defeats the objective of monetary order as surely as failure of deficit countries to attack the source of their deficits. Any effort to develop a balanced and equitable monetary system must recognize that simple fact; effective and symmetrical incentives for adjustment are essential to a lasting system.

Fourth, while insisting on the need for adjustment, we can and should leave considerable flexibility to national Governments in their choice among adjustment instruments. In a diverse world, equal responsibility and equal opportunity need not mean rigid uniformity in particular practices. But they do mean a common commitment to agreed international objectives. The belief is widespread — and we share it — that the exchange-rate system must be more flexible. However, important as they are, exchange rates are not the only instrument of adjustment policy available; nor, in specific instances, will they necessarily be the most desirable.

Fifth, our monetary and trading systems are an interrelated complex. As we seek to reform monetary rules, we must at the same time seek to build in incentives for trade liberalization. Certainly, as we look ahead, ways must be found to integrate better the work of the GATT and the I.M.F. Simultaneously we should insure that there are pressures which move us toward adequate development assistance and away from controls which stifle the free flow of investment.

Finally, and perhaps most fundamental, any stable and well-functioning international monetary system must rest upon sound policies to promote domestic growth and price stability in the major countries. These are imperative national goals for my Government—and for yours. And no matter how well we design an international system, its prospects for survival will be doubtful without effective discharge of those responsibilities.

Today is not the occasion for presenting a detailed blueprint for monetary reform. However, I do want to supplement these general principles with certain specific and interrelated ideas as to how to embody these principles in a workable international agreement.

These suggestions are designed to provide stability without rigidity. They take as a point of departure that most countries will want to operate within the framework of specified exchange rates. They would encourage these rates to be maintained within specified ranges so long as this is accomplished without distorting the fabric of trade and payments or domestic economic management. We aim to encourage freer flows of trade and capital while minimizing distortions from destabilizing flows of mobile capital. We would strengthen the voice of the international community operating through the I.M.F.

I shall organize these ideas under six headings, recognizing that much work remains to be done to determine the best techniques in each area: the exchange-rate regime: the reserve mechanism; the balance-of-payments adjustment process; capital and other balance-of-payments controls; related negotiations; institutional implications.

[1] Exchange-Rate Regime

We recognize that most countries want to maintain a fixed point of reference for their currencies — in other words, a "central" or "par" value. The corollary is a willingness to maintain and support these values by assuring convertibility of their currencies into other international assets.

The New York Times/Mike Lien

George P. Shultz, Secretary of the Treasury, as he spoke in Washington yesterday. Behind him is Pierre-Paul Schweitzer of the International Monetary Fund.

A margin for fluctuation for market exchange rates around such central values will need to be provided sufficiently wide to dampen incentives for short-term capital movements, and, when changes in central values are desirable, to ease the transition. The Smithsonian Agreement took a major step in that direction. Building on that approach in the context of a symmetrical system, the permissible outer limits of these margins of fluctuation for all currencies—including the dollar—might be set in the same range as now permitted for nondollar currencies trading against each other.

Monetary Unions

We also visualize, for example, that countries in the process of forming a monetary union—with the higher degree of political and economic integration that that implies—may want to maintain narrower bands among themselves, and should be allowed to do so. In addition, an individual nation, particularly in the developing world, may wish to seek the agreement of a principal trading partner to maintain a narrower range of exchange-rate fluctuation between them.

Provision needs also to be made for countries which decide to float their currencies. However, a country that refrains from setting a central value, particularly beyond a brief transitional period, should be required to observe more stringent standards of behavior in other respects to assure the consistency of its actions with the basic requirements of a cooperative order.

[2] Reserve Mechanism

We contemplate that the S.D.R. [Special Drawing Right] would increase in importance and become the formal numeraire of the system. To facilitate its role, that instrument should be freed of those encumbrances of reconstitution obligations, designation procedures, and holding limits, which would be unnecessary in a reformed system. Changes in the amount of S.D.R.'s in the system as a whole will be required periodically to meet the aggregate need for reserves.

A "central-value system" implies some fluctuation in official reserve holdings of individual countries to meet temporary disturbances in their balance-of-payments positions. In addition, countries should ordinarily remain free to borrow or lend, bilaterally or multilaterally, through the I.M.F. or otherwise.

At the same time, official foreign-currency holdings need be neither generally banned nor encouraged. Some countries may find holdings of foreign currencies provide a useful margin of flexibility in reserve management, and fluctuations in such holdings can provide some elasticity for the system as a whole in meeting sudden flows of volatile capital. However, careful study should be given to proposals for exchanging part of existing reserve-currency holdings into a special issue of S.D.R.'s, at the option of the holder.

The suggested provisions for central values and convertibility do not imply restoration of a gold-based system. The rigidities of such a system, subject to the uncertainties of gold production, speculation, and demand for industrial uses, cannot meet the needs of today.

I do not expect Governmental holdings of gold to disappear overnight. I do believe orderly procedures are available to facilitate a diminishing role of gold in international monetary affairs in the future.

[3] Balance-of-Payments Adjustment Process

In a system of convertibility and central values, an effective balance-of-payments adjustment process is inextricably linked to appropriate criteria for changes in central values and the appropriate level, trend, and distribution of reserves. Agreement on these matters, and on other elements of an effective and timely adjustment process, is essential to make a system both practical and durable.

There is, of course, usually a very close relationship between imbalances in payments and fluctuations in reserve positions. Countries experiencing large deterioration in their reserve positions generally have had to devalue their currencies or take other measures to strengthen their balance of payments. Surplus countries with disproportionate reserve gains have, however, been under much less pressure to revalue their currencies upward or to take other policy actions with a similar balance-of-payments effect. If the adjustment process is to be more effective and efficient in a reformed system, this asymmetry will need to be corrected.

I believe the most promising approach would be to insure that a surfeit of reserves indicates, and produces pressure for, adjustment on the surplus side, as losses of reserves already do for the deficit side. Supplementary guides and several technical approaches may be feasible and should be examined. Important transitional difficulties will need to be overcome. But, in essence, I believe disproportionate gains or losses in reserves may be the most equitable and effective single indicator we have to guide the adjustment process.

Variety of Responses

As I have already indicated, a variety of policy responses to affect the balance of payments can be contemplated. An individual country finding its reserves falling disproportionately would be expected to initiate corrective actions. For example, small devaluations would be freely permitted such a country. Under appropriate international surveillance, at some point a country would have a prima facie case for a larger devaluation.

While we must frankly face up to limitation of the use of domestic monetary, fiscal, or other internal policies in promoting international adjustments in some circumstances, we should also recognize that the country in deficit might well prefer—and be in a position to apply—stricter internal financial disciplines rather than devalue its currency. Only in exceptional circumstances and for a limited period should a country be permitted direct restraints, and these should be general and nondiscriminatory. Persistent refusal to take fundamental adjustment measures could result in withdrawal of borrowing, S.D.R. allocation, or other privileges.

Conversely, a country permitting its reserves to rise disproportionately could lose its right to demand conversion, unless it undertook at least limited revaluation or other acceptable measures of adjustment. If reserves, nonetheless, continued to rise and were maintained at those higher levels over an extended period, then more forceful adjustment measures would be indicated.

Surcharges Considered

For a surplus as for a deficit country, a change in the exchange rate need not be the only measure contemplated. Increasing the provision of concessionary aid on an united basis, reduction of riers, and elimination of obtariffs and other trade barstacles to outward investment could, in specific circumstances at the option of the nation concerned, provide supplementary or alternative means. But, in the absence of a truly effective combination of corrective measures, other countries should ultimately be free to protect their interests by a surcharge on the imports from the chronic surplus country.

For countries moving toward a monetary union, the guidelines might be applied on a collective basis, provided the countries were willing to speak with one voice and to be treated as a unit for purposes of applying the basic rules of the international monetary and trading system.

[4] Capital and Other Balance-of-Payments Controls

It is implicit in what I have said that I believe that the adjustment process should be directed toward encouraging freer trade and open capital markets. If trade controls are permitted temporarily in extrems cases on balance-of-payments grounds, they should be in the form of surcharges or across-the-board taxes. Controls on capital flows should not be allowed to become a means of maintaining a chronically undervalued currency. No country should be forced to use controls in lieu of other, more bacic, adjustment measures.

[5] Related Negotiations

We welcome the commitments which major nations have already made to start detailed trade negotiations under the GATT in the coming year. These negotiations, dealing with specific products and specific restraints need not wait on monetary reform, nor need monetary reform await the results of specific trade negotiations.

Those negotiations, and the development of rules of good behavior in the strictly monetary area, need to be supplemented by negotiations to achieve greater equity and uniformity with respect to the use of subsidies, and fiscal or administrative pressures on trade and investment transactions. Improper practices in these areas distort trade and investment relationships as surely as do trade barriers and currency disequilibrium. In some instances, such as the use of tariff surcharges or capital controls for balance-of-payments purposes, the linkage is so close that the Committee of 20 must deal with the matter directly. As a supplement to its work, that group can help launch serious efforts in other bodies to harmonize countries' practices with respect to the taxation of international trade and investment, the granting of export credit, and the subsidization of international investment flows.

[6] Institutional Implications

As I look to the future, it seems to me that there are several clear-cut institutional requirements of a sensible reform of the monetary and trading system.

Several times today, I have stressed the need for a comprehensive new set of monetary rules. Those rules will need to be placed under guardianship of the I.M.F., which must be prepared to assume an even more critical role in the world economy.

Given the interrelationships between trade and payments, that role will not be effectively discharged without harmonizing the rules of the I.M.F. and GATT and achieving a close working relationship.

Finally, we need to recognize that we are inevitably dealing with matters of essential and sensitive national interest to specific countries. International decision-making will not be credible or effective unless it is carried out by representatives who clearly carry a high stature and influence in the councils of their own Governments. Our international institutions will need to reflect that reality, so that in the years ahead national Governments will be intensively and continuously involved in their deliberations and processes. Without a commitment by national Governments to make a new system work in this way, all our other labors may come to naught.

Conversion of Assets

I am fully aware that the United States, as well as other countries, cannot leap into new monetary and trading arrangements without a transitional period. I can state, however, that after such transitional period the United States would be prepared to undertake an obligation to convert official foreign dollar holdings into other reserve assets as a part of a satisfactory system, such as I have suggested—a system assuring effective and equitable operation of the adjustment process. That decision will, of course, need to rest on our reaching a demonstrated capacity during the transitional period to meet the obligation in terms of our reserve and balance-of-payments position.

We fully recognize that we have not yet reached the strength we need in our external accounts. In the end, there can be no substitute for such strength in providing the underpinning for a stable dollar and a stable monetary system.

An acceptable monetary system requires a willingness on the part of all of us to contribute to the common goal of full international equilibrium. Lacking such equilibrium, no system will work. The equilibrium cannot be achieved by any one country alone.

Efforts Thwarted

We engage in discussions on trade and financial matters with a full realization of the necessity to continue our own efforts on a broad front to restore our balance of payments. I must add, in all candor, that our efforts to improve our position have, in more than one instance, been thwarted by the reluctance of others to give up an unjustified preferential and highly protected market position. Yet without success in our endeavor, we cannot maintain our desired share in the provision of aid, and reduce our official debt to foreign monetary authorities.

We take considerable pride in our progress toward price stability, improved productivity, and more rapid growth during the past year. Sustained into the future, as it must be, that record will be the best possible medicine not only for our domestic prosperity, but for the effective functioning of the international financial system.

My remarks today reflect the large agenda before us. I have raised difficult, complicated, and controversial issues. I did not shrink from so doing for a simple reason: I know that you, as we, want to move ahead on the great task before us.

Let us see if, in Nairobi next year, we can say that a new balance is in prospect, and that the main outlines of a new system are agreed. We owe ourselves and each other that effort.

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