The shape of the new monetary system

At deadline, the American dollar stood at a year's low of 1.74 to the West German mark and 1.55 to the Swiss franc, following a strong late Wednesday afternoon attack on the currency. The continuation of this downslide is somewhat unlikely, given the success of Western European monetary diplomacy this week. European foreign exchange traders think a dollar support package may be announced the weekend of Sept. 28.

The short-term behavior of the foreign exchange market is influenced by factors which will be discussed

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below. They are, however, overshadowed by the now-perceptible shape of a new monetary system which will replace the remnants of the Bretton Woods institutions. No less than this was revealed by M. François-Poncet, the foreign minister of France, at a Sept. 26 press conference at the United Nations (see INTERNATIONAL for transcript). In a precedent-breaking statement responding to a question from this publication, François-Poncet declared that the intention of the European Monetary System was to become the core of a worldwide gold-based monetary system which would replace the International Monetary Fund. He did not give a timetable for this. Judging, however, from the profile of the markets, events are now moving quickly.

According to numerous foreign exchange trading sources in New York and Frankfurt, the attack on the dollar began with a significant move from the dollar into sterling—which rose Sept. 26 from $2.16 to $2.19, and then on Sept. 27 to $2.20. The occasion for the sterling rise was a rumor that the meeting of OPEC finance ministers concluding today in Vienna would decide to demand payment in sterling for at least some part of their oil exports.

After the Kuwaiti minister gave a statement widely circulated on European media Sept. 27 that the rumors concerning sterling oil payments were wholly without merit and that the OPEC countries would continue to want payment in dollars, sterling began to fall. At midday on Sept. 27, the markets had quieted, waiting for additional news and a final communiqué from the Vienna meeting. Apparently, the major move into sterling had come from large oil companies.

However, the move into sterling had already provoked a significant flow from the dollar into German marks and Swiss francs, creating disorderly conditions on the markets. The Federal Reserve bought $500 million on the afternoon of Sept. 26.

Much more important than the rise of the dollar as a factor in the markets, however, was the jump in the gold price to $395 at the London afternoon fixing Sept. 27, and to over $400 in later trading in the New York market (see Gold). The apparent basis for this rise is OPEC discussions concerning pegging the oil price to a currency basket including gold. Essentially, that means pegging the oil price to the European Currency Unit (ECU). One well-placed Frankfurt market source believes that the OPEC discussions (reports of which circulated widely in the financial press Sept. 27), the rise in the gold price, and an apparent Italian initiative to recognize the Palestine Liberation Organization reported over European wire services were part of a European Arab package.

Here is what is going on in the markets:

First, the most prestigious among commercial bank newyletters, Rimmer de Vries' *World Financial Markets*, published by Morgan Guaranty Trust, warns that current proposals to substitute some form of Special Drawing Right for the dollar as a significant step towards taking reserve pressures off the dollar are "going nowhere." The current plans—to be a major subject of discussion at next week's annual meeting of the International Monetary Fund in Yugoslavia—are a non-starter, de Vries argues, citing the problems of interest rates (the SDR currently bears only 80 percent of the average interest rate of the currencies that make up its valuation) and exchange risk. (The same themes were reiterated Sept. 26 by Commerzbank Chairman Robert Dhom in an AP/Dow Jones interview). De Vries' view jars markedly with the continued adherence to the moribund SDR plan by American Treasury and Federal Reserve, as well as the *New York Times*, which reiterated the theme again in a Sept. 27 editorial.

What de Vries wants is a kind of gold-backed SDR! He proposes that the IMF *re-monetize* its gold stocks, worth $30 billion at the market prices, to provide the required exchange rate guarantee. The problem in this proposal is, if the IMF is going to go to the trouble of remonetizing gold, why bother with the SDR in the first place. Even de Vries is not sanguine about the acceptability of this plan in Western Europe.

The question of dollar support operations is intensely problematic. Many American banking economists are now concerned that a further rise in interest rates would not only deepen the recession, but provoke dangerous and perhaps uncontrollable problems for parts of the credit system (see Domestic Credit). There had been speculation that with Bundesbank vice-president Karl-Otto Poehl's forthcoming accession to the presidency of Bundesbank, the Bundesbank might become more willing to accept a greater DM reserve role at the expense of the dollar, and to accept a further downward drift of the dollar. Indeed, the *New York Times'* editorial of Sept. 24, "A Leaden Foot on the Monetary Brakes," argued strongly against tighter money which traded off American economic ills for a temporarily stronger dollar. This position is also held by Rep. Henry Reuss, the chairman of the House Banking and Currency Committee. Bundesbank staffers loyal to Poehl say they are in basic harmony with this outlook, as opposed to the imputed "Volcker-Emminger" approach to tight money on both sides of the Atlantic.

However, in a Sept. 26 press conference, Emminger stated bluntly that "West Germany will not become the dumping ground for unwanted dollars." The viability of such a policy drift is strongly in doubt.

Well-informed economic commentators also believe that there is no basis to expect a short-term push for exports to have any effect. "Especially if there is a major legislative initiative involved," said a senior advisor to the U.S. Treasury, "there is no chance of anything happening." This view was also reiterated by a top-ranking Senate aide. "It's not just a matter of exchange rates or export credit, the aide said. "The U.S. economy is not in shape for an export drive."

The danger is one of panic and retrenchment in the United States. "We are moving from an era of multilateralism to an era of bilateralism," the Senate aide said. "We've got to start going big with Canada and Mexico."

—*David Goldman*

A European-Arab

World currency and gold markets were in a state of panic as of our Sept. 27 deadline, with gold trading at over $400 an ounce in New York. The subject of the panic is the OPEC finance ministers' meeting in Vienna and the possibility that Arab oil-producing nations will join European Monetary System (EMS) members in initiating a new gold-based monetary system.

The manic sell-off of dollars was apparently precipitated by leading New York and London banks and oil

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multinationals as a last-ditch gambit to destabilize the EMS through a new dollar crisis. The dollar's instability is the major remaining obstacle to the success of the EMS.

Among informed financial circles, there is little question now that gold has been returned to "the center of the monetary universe." The state of mind of the Anglo-American faction jeopardized by the EMS is perhaps best exemplified by Morgan Guaranty economist Rimmer de Vries's hasty proposal that the IMF use its $30 billion in gold holdings as "backing" for the proposed Special Drawing Right "substitution account." In reality, no continental European government will tolerate the use of the SDR as an alternative reserve currency, whether it has a gold component or not, because perpetuation of the IMF's severe austerity policies is seen as too great a threat to world economic growth and trade. What is under consideration is the creation of a gold-backed European "super-currency," perhaps through the further evolution of the European Currency Unit (ECU), or alternatively, a revival of the U.S. dollar based on the U.S. government's still substantial gold holdings.

The crisis among top policymaking circles in Washington and London was underscored by the Sept. 26 *Sunday Telegraph*'s report that the U.S. Treasury is about to abandon its eight-year campaign to demonetize gold. According to the *Telegraph*, more than a cessation of the Treasury's monthly gold auctions is at issue. The British newspaper went so far as to report that the Treasury will oppose SDR substitution at the upcoming Belgrade IMF conference and will float instead a plan to promote gold's role as an international monetary reserve.

One-third of world reserves

What disturbs the Atlanticist grouping most is the