I. THE EXCHANGE RATE MECHANISM

The present (Smithsonian) exchange rate arrangements are precarious. The necessarily urbane and balanced language of the Executive Directors of the International Monetary Fund in their Report on the Reform of the International Monetary System probably will not convey to many readers their actual precariousness.

The Smithsonian readjustment of parities (and "central rates"), combined with the widening of the margins within which actual rates are to be confined, is providing for some relaxation of tension. But the Bretton Woods system, so excellent and so helpful for so many years, is now deeply cracked: neither of the two reserve-currencies, neither the dollar nor sterling, is able to withstand the strains that have been laid on it; the link between the dollar and gold, which was central to the system has been shattered and neither gold nor the dollar nor (in its present embryonic form) the SDR can serve as an acceptable "neutral" foundation for the system; and, perhaps worst of all, the IMF system of determining par values, at least as between major currencies, has been weighed and found wanting.

The Smithsonian arrangements effectively papered over some of the cracks. But the break-away of sterling within six months made it clear that (to use the phrase employed by the Executive Directors) the system is still "crisis-prone".

The developing countries have as much, perhaps more, to lose from a disintegration of the system, and a breakdown of exchange-arrangements between the major developed countries, as those countries themselves. A breakdown of the post-war regime of expansionist liberal internationalism, with its relative freedom of access to expanding world markets for the staple export products of developing countries and its ability to provide at least a measure of development assistance in a variety of forms, could quite possibly revert towards the sauve-qui-peut nationalist economic warfare of the 1930s in which the weaker countries, with less diversified economies and less sophisticated finances, are almost sure to suffer most.

It is a common-place to observe that world commodity markets and world commodity prices react adversely to financial crises. It is also necessary to stress the particularly damaging effects on aid programmes and capital exports of the ever-deepening balance of payments crises. When a major country's balance of payments goes into heavy deficit, the external aid programme (for which domestic political support is likely to be chronically insecure) is almost certain to be amongst the early casualties: its growth (under the international 1 per cent target) is interrupted; it may even be cut back; and its quality is impaired by "tying". Nor is there much evidence that countries experiencing heavy surpluses are disposed to apply them promptly and liberally to capital exports and other assistance to the developing countries. On the contrary, the aid contributions of countries going into surplus are usually poor in both quantity and quality. A steady flow of capital exports and aid from the industrialized countries depends in very large measure on stability of balance-of-payments relationships amongst them. And, in the Bretton Woods system as it has developed over time, such stability is by now conspicuously lacking.

There are unfortunate indications in the present situation of a propensity towards competitive exchange-rate depreciation amongst major industrialized countries. It is true that the IMF Agreement provides a measure of protection against the disruption involved in attempts at competitive depreciation; but it is surely too much to say, as the Executive Directors do, that it still provides "assurance" against such disruption, particularly if major countries are disposed to use the exchange rate in jockeying for position. Another aspect of the unsatisfactory exchange situation is the obvious reluctance of major countries to revalue their currencies upward when, at least to outsiders, the situation would seem to warrant it.

The phrase "at least to outsiders" brings out a point that is frequently mentioned, but perhaps not fully developed, in the Executive Directors' report: the concern of other countries in the exchange rate of any major country. Indeed there is probably no country, however minor, whose exchange rate is not of concern to one or more other countries whose export products are competitive. A greater recognition of the international implications and repercussions of exchange-rate decisions must be built into the new system.

At the time of Bretton Woods there were few who would have challenged the doctrine that a national currency was a matter of national sovereignty and that such sovereignty related as much to the external (exchange-rate) aspect of the currency as to its internal (monetary and central banking) aspect. This doctrine is embodied in Article IV of the IMF Agreement which provides that a change in the par value of a currency may be made "only on the proposal of the member" concerned; further, that provision is entrenched by Article XVII which precludes any change in it unless that change is accepted by **all** members of the Fund! True, under Article IV, a member proposing to change the parity of its currency is obliged to "consult" with the Fund, but in the last analysis sovereignty is clearly national.

The Fund may make, and in recent years has increasingly made, informal proposals to member countries about their exchange rates. But such proposals are informal and obviously carry less weight with countries in a "strong" position that they do with those in a "weak" position.

The political doctrine that each country is naturally and completely sovereign over the external (exchange-rate) value of its currency in fact makes no economic sense. On the contrary, since each country's exports (whether visible, invisible, or capital) are some other country's imports, the outside world is **equally** concerned, along with the country itself, in movements of "its" exchange rate. The concern of the outsiders is, of course, more diffused than the concern of the people inside the country, but it is economically just as large and just as real.

It is a question for developing and for industrialized countries alike to consider how far to press the interest of the outside world in exchange-rate determination. For each country, any sacrifice of national sovereignty may incur risks. But it may equally involve advantages. For both developing and industrialized countries, economic decisions regarding exchange-rate changes are fraught with political difficulties.

Some developing countries have, as yet, little experience of decision-making in regard to the external (exchange rate) value of their newly-independent currencies. They may do well to take a special interest in the range of proposals in the Executive Directors' Report, relating to "objective indicators" for exchange-rate determination, and also relating to the role of Fund initiative in these matters. No "objective indicators" are likely to yield perfect or uncontroversial results in the determination of par values; but they are surely likely to provide a better basis, a better approximation to what is desirable in a world system, than decisions that are highly political in their nature and unilateral rather than multilateral in their purview.

The Executive Directors' report indicates that developing countries are generally resistant to the various proposals for more flexible exchange rates (parities) amongst the major industrialized countries. The same point emerges in resolutions of UNCTAD and other groupings of developing countries. However this is a point that deserves examination.

Superficially, and prima facie, stable exchange rates as between the major markets for primary products hold out obvious short-run advantages and conveniences for exporters to those markets. Movements of these rates, both actual and anticipated, introduce uncertainties which can be costly, whether in terms of some sort of insurance against them or in actual losses incurred in marketing. The fact that the marketing of many primary products involve contracts, not only externally between national marketing authorities and overseas buyers but also internally between such authorities and producers, accentuates the difficulties and discomforts, political as well as economic, involved in exchange rate instability. Thus, to the simple question whether stability is preferable to instability there can be only one answer.

But, in a crisis-prone international system, this question is surely not the right one; it is not a simple issue between stability and instability, between certainty and uncertainty. We live in a very dynamic and hence uncertain economic environment and the question is not **whether** uncertainty should be confronted but rather **how** it should be confronted. In recent weeks the present author has repeatedly posed, to authorities concerned with these matters in developing countries, a question which is probably more nearly the right one: Since it seems that any attempt to maintain virtual fixity of exchange rates amongst major currencies over considerable periods of years nowadays entails the build-up of international financial crises, attended by restrictions of various sorts, internal and external, interruptions to external aid, and ultimate major movements of exchange rates, would not developing countries find preferable a system in which major exchange rates move more frequently but less violently, particularly if such movements can be related in some way to "objective indicators" which are known and understood by all concerned? To this question, whether the smoother adjustment is not preferable to the crisis-prone adjustment, the reply is always in favour of the smoother.

It would be reasonable to assume that more frequent movements of major exchange rates, albeit moderate in extent, are likely to be a feature of the system of the future. Fortunately, the additional difficulties arising for developing countries in such a system, while by no means negligible, are at the same time not entirely insuperable. For example these countries are already fully accustomed to the use, in commodity markets, of hedging against future price movements; they may now be well advised to explore actively and fully various ways of mitigating the difficulties and uncertainties that are likely to be involved in exchange movements. Those developing countries whose financial systems have as yet made little provision for "forward cover" in exchange rates would be well advised to explore this matter forthwith. In view of the very great variety of situations in different international exchange and commodity markets, and the differing financial systems in different countries, what is needed is expert advice and impartial technical assistance adapted to the particular circumstances of each country. In the provision of such advice and assistance the Fund ought to be able to be helpful. The technical assistance facilities recently provided under the auspices of the Commonwealth Secretariat might also be employed.

II. INTERNATIONAL RESERVES AND RESERVE CURRENCIES

There is widespread support for the proposal that the SDR should be developed, as soon as possible, into an accepted, and generally utilized, world reserve asset. Such support seems, naturally enough, to be strong amongst developing countries. The emergence of such a "neutral" asset, under international control, could offer some escape from various objections and uncertainties. Politically, it is preferable to avoid holding a reserve in the national currency of some other country. Economically, insofar as a country holds its reserves in