International Monetary Developments

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Edinburgh Finance & Investment Seminar
Glasgow Discussion Group on Finance & Investment, Edinburgh

Tuesday, June 22, 1999

1. Premise

The fact that close international cooperation in the economic and social as well as in the cultural sphere is a worthy pursuit does not have to be emphasised on this occasion. If, however, we are convinced that this endeavour is in fact important, there must be clarity as to what it takes to succeed. My following remarks are intended to make a contribution to this end. For obvious reasons, the main focus will be on international monetary developments.

Reasonably stable currency relations are a decisive precondition for successful economic cooperation beyond one's own borders. Such relations are ultimately the result of a sustained convergence of solid economic policies implemented by individual countries. Unfortunately, the push toward globalisation often clouds the perception that at least for the foreseeable future, each country must take responsibility for its own actions and failures to act. Guaranteeing reasonably stable currency relations is, in the final analysis, a social challenge. It is vital that individual countries muster the necessary discipline for a sustained effort. This cannot be achieved with institutional means alone. The respective rules and regulations are a necessary, but not a sufficient basis for success.

2. Possible solutions

Looking back over the past hundred years, three different models for shaping international monetary relations can be distinguished: the Gold Standard, the Bretton Woods agreements and a flexible exchange rate system.

With the Gold Standard, the value of different currencies was defined in terms of gold, which also established the parity between individual currencies. This regulation severely curtailed the individual central banks' room for manoeuvre. Defending the gold parity of their own currency was the primary concern. Imbalances in international economic relations led to gold movements. These movements subsequently triggered either expansive or restrictive monetary impulses in the countries affected, which tended to restore the balance.

The Gold Standard was in its prime during the decades before and after the turn of the last century, a period characterised by widespread economic stability in individual countries. International economic relations and overall economic growth developed at a correspondingly favourable pace. The term "globalisation" applies to this past period as much as it does to the present time.

However, in evaluating the Gold Standard, a distinction must be made between fact and fiction. It was, after all, not gold itself that paved the way for a favourable development, but rather the willingness of individual countries to subordinate their national economic policy interests to the requirements of foreign trade. Gold merely had the function of indicating a need for adjustments. When countries began to set priorities differently in pursuing their economic policy goals, these signals were increasingly ignored. By then, the sands were running out for the Gold Standard.

While the Gold Standard had developed rather informally, the Bretton Woods regulations were the result of concrete international agreements which were already negotiated during the Second World War and finalised immediately after it was over. The idea behind these agreements was to regulate international monetary relations in an attempt to strike a balance between flexibility and pegging.

While exchange rates were to be fixed, they should nevertheless be adjustable in the event of fundamental imbalances. The possibility of taking corrective action was introduced in order to facilitate the adjustment process. Individual countries were granted the right to limit the free flow of capital. These regulations, of course, reflect a change in attitude with respect to the priorities of economic policy. Even though close economic integration between individual countries basically remained a desirable goal, it was not necessarily considered an economic priority. In the final analysis, it was a question of attempting to find an optimal compromise between conflicting interests of policies focused on domestic and international objectives.

With a view to implementing the intentions contained in the Bretton Woods agreements, the International Monetary Fund was assigned the task of promoting international monetary cooperation. Economic policy counselling, specialist technical support and financial assistance in the form of loans to help ease adaptation processes have become the main elements of its activities.

Experience has subsequently shown that institutional regulations are a necessary, but insufficient requirement for success. It is indispensable for individual countries to make their own contributions. In the course of time, finding a proper balance between stressing the self-reliance of a member country and support from the international community represented in the IMF has become the true leitmotiv.

Around the mid-seventies, the transition was made to a floating exchange rate system, which, at the time, gave rise to high hopes. It was believed that with exchange rates becoming more flexible, the conflicting interests between autonomous action and cooperation would largely become non-existent.

A quarter of a century later, the experience gained presents a mixed picture. Positively, flexible exchange rates have proved to be a suitable instrument for overcoming imbalances. Despite sizeable differences in the economic development of individual countries, economic interchange has become considerably more pronounced. If, however, the need for adjustment goes beyond a certain level both in manner and scope, even flexible exchange rates can no longer provide a remedy. Again, the assertion that it is imperative for individual countries to keep their own house in order has shown itself to be correct. This insight has also proved to be true in times when greater freedom of capital movements resulted in more sensitive reactions to wrong developments.

Occasionally, attempts have been made to counteract extraordinary exchange rate developments with official market interventions. Economics and experience have shown, however, that such interventions only make sense when they are coupled with a change in the course of monetary policy.

3. Current situation

In recent times, international monetary relations around the world have been influenced by the well-known developments in Asia, Russia and Latin America.

These developments may have their characteristic features in individual cases; they nevertheless give rise to a number of comments of a more general nature.

In my opinion, it is essential to recognise that imbalances in economic development, weak financial systems and insufficient supervision of financial markets are merely symptoms of deeper-lying causes. Our most recent experiences serve to confirm the opinion that sustained economic development is only possible on the basis of social and economic stability. First and foremost, however, individual countries themselves bear the responsibility for creating this stability. In so doing, they ultimately make the best contribution toward international cooperation.

In the course of developments in recent years, the International Monetary Fund has increasingly been in the limelight and, at the same time, also under attack. This is a fairly normal development. Even though criticism of the institution with prime responsibility for international monetary cooperation is nothing unusual, it nevertheless frequently seems to be exaggerated.

As mentioned earlier, since its inception, the IMF has had to strike a balance between stressing the self-reliance of individual countries and a readiness to facilitate adjustment processes. This will not change much in the future either. Walking this tightrope is not made any easier by the fact that even this multinational institution is not immune to political influences. In this respect, too, things will hardly change. The situation is further complicated because the Monetary Fund is only able to enforce its recommendations to a limited degree. Moreover, it is obvious that the means at its disposal for granting financial assistance in the form of loans will always be limited.

Such situations cannot be mastered with institutional means alone. The regularly recurring call for reform of the international monetary order can change little in this respect. Naturally, this does not rule out improvements. However, in my opinion, conceptual questions are not the main issue. The primary need is actually to implement what has been recognised as basically right.

Improved transparency of financial market transactions is an essential goal. This will enable both official authorities and private market participants to make a more accurate assessment of the situation. At the same time, it cannot be overlooked that errors and failures are frequently due to the inappropriate evaluation of actually available information rather than to a lack of transparency.

Another urgent matter is improved supervision of national financial markets. Again, conceptual questions are hardly the issue, since these have been dealt with by various bodies in recent years. The emphasis is now on the consistent application of the insights gained.

Yet another difficult chapter is the question of participation by the private sector in preparing for, and overcoming, crisis situations. The basic principle should be to hold the private sector responsible for its own actions and failures to act. Official financial aid in the form of credits may not extend to the point of relieving it of its responsibility. This, of course, applies to both the domestic and foreign private sectors.

4. European Monetary Union

The European Monetary Union must be included in any consideration of developments in the international monetary sphere. Its formal realisation at the beginning of this year represents a significant turning point both for the countries immediately affected as well as for the remaining European countries.

If the European Monetary Union develops according to plan, the preconditions for productive economic development in Europe will undoubtedly improve markedly. It is not, however, the single currency as such that is of decisive importance, but rather what lies behind, namely a sustained convergence of stability-oriented policies, at least in the major countries.

In the context of the run-up to monetary union, significant progress has been made in this respect in the participating countries. Inflation has been contained and government budgets have been brought in line with lasting effect.

In view of the challenges that lie ahead, one must bear in mind that with the fixing of exchange rates, individual countries have forfeited an element of flexibility in their economic policies. Imbalances in economic development could formerly be compensated with flexible exchange rates. Losing this possibility is significant since flexibility is already lacking in numerous countries today.

The European Central Bank has clearly stated its position on the question of its strategy. It has offered a concrete definition of its view of price stability: the consumer price index is not to exceed 2% p.a. However, an inflation target was not formulated. At the same time, the significance of the development of the money stocks is emphasised.

I note with satisfaction that these ideas are largely in conformity with our own thinking. The chances are thus good that this will result in a sustained convergence of stability-oriented policies and, as a consequence, basically stable currency relations between Switzerland and the new monetary area. With this scenario, we would not have to contend with undue repercussions on the Swiss franc. Should, however, difficulties arise when the present goals are implemented, we would have to expect some turbulence. This is likely to result in upward pressures on the Swiss franc. The National Bank would have the possibility of relaxing monetary policy to counteract such a trend. This might, however, conflict with its policy's orientation towards stability.

All this implies that a small and open country such as Switzerland only has limited room for manoeuvre in conducting its monetary relations. There are basically two options. The country's currency can be pegged to the currency of another country. That, however, means having to relinquish an independent monetary policy. A previously existing favourable interest rate differential would at least be significantly reduced. Our economy would be burdened with substantial adjustment costs. The other possibility would be to keep currency relations flexible, thereby preserving a greater measure of autonomy. There is obviously no ideal solution. There would be no objection to a fixed link if the policy of the partner matched one's own ideas and if this could be assumed to remain the case also in the future. This second precondition is rarely ever met, which seems to favour the option providing for more autonomy in the conduct of monetary policy.

After a good start, the euro has now entered more turbulent waters. As far as I can see, there are various reasons for this. Diverging economic developments in the United States and in Europe are an important factor. Secondly, the implications of the revived economic policy debate in Europe must be mentioned. Finally, a certain euphoria, which made itself felt in the preparatory phase and when the euro was launched, has given way to a more sober attitude.

The development has not reached a critical point as yet. However, the responsible persons and bodies are well advised to give their full attention to the further course of events. When all is said and done, the experience gained during this short period already serves to confirm the prediction that success will depend on the ability of participants to muster the discipline necessary for a sustained stability-oriented policy.

5. Outlook

In the past decades, the quality and scope of the economic and social environment have changed considerably. The experience gained in the course of this development has, however, also shown that a number of basic insights must be taken into account.

In particular, I would like to point out once more that even in the economic sphere, sustained international cooperation is only possible among countries that have achieved economic and social stability. The demand made on any individual country is therefore first and foremost to keep its own house in order.

This will in all circumstances be a difficult and onerous task. Moreover, it is obvious that the preconditions for success vary from one country to another. Outside help is therefore indispensable in many cases. Such assistance can, however, only be effective if it is provided in the form of help towards self-help.

International financial relations are supported mainly by the private sector. Basic conditions must be designed so as to be conducive to the stability and integrity of such relations. Good use should be made of market forces in creating these conditions.

If the difficult circumstances in which the International Monetary Fund has to perform its task are taken into account, its activity can be rated as mainly positive. The institution's mandate and self-image have changed in line with the changing environment in the course of time. That will also be the case in the future. What is important, in the final analysis, is to take due care to maintain a balance between conceptual adjustments and their consistent implementation.