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Fragile Finance

Rethinking the International Monetary System

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Abbreviations

ADR	American Depository Receipts
BIS	Bank for International Settlements
CCFF	Compensatory and Contingency Financing Facility
CD	Certificate of Deposit
CIS	Commonwealth of Independent States
CTC	Chilean Telephone Company
C-20	Committee of Twenty
DFI	Direct Foreign Investment
EC	European Community
ECLAC	Economic Commission for Latin America and the Caribbean
EE	Eastern Europe
EEC	European Economic Community
EMS	European Monetary System
FDI	Foreign Direct Investment
FEER	Fundamental Equilibrium Exchange Rate
FTA	Free Trade Area
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
GSP	Generalised System of Preferences
G-7	Group of Seven
IDA	International Development Association
IFC	International Finance Corporation
IFI	International Financial Institution
IMF	International Monetary Fund
IMS	International Monetary System
LAC	Latin America and the Caribbean
LDC	Less Developed Country
LIBOR	London Inter-Bank Offer Rate
MITI	Ministry of International Trade and Industry (Japan)
NAFTA	North American Free Trade Agreement
NAIRU	Non-Accelerating Inflation Rate of Unemployment
NIC	Newly Industrialising Country
NTB	Non-Tariff Barrier
OBS	Off Balance Sheet
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
PPP	Purchasing Power Parity
SDR	Special Drawing Right
UNCTAD	United Nations Conference on Trade and Development
UNICEF	United Nations Children's Fund
UNU	United Nations University
WIDER	World Institute for Development Economics Research

Introduction

Looking at the history of the international monetary system in the 19th and 20th century, it is not difficult to distinguish the various stages of its development, assess its performance, and explain why subsequent reforms of the system came about. With the benefit of hindsight, it seems logical that the original 'gold standard' (based on the British pound and its convertibility into gold) was replaced by the 'gold exchange standard' (based on the US dollar and its convertibility into gold) after the Second World War, and that this system, in its turn, was abandoned in 1971 when the United States, because of its growing indebtedness to the rest of the world, could no longer guarantee the dollar's value in gold. The more recent history of the world monetary system shows, however, that it is hard to reach consensus on its successes and failures, agree on the reforms required, and, eventually, get sound ideas put into practice.

The past three decades supply testimony to this lack of consensus. Efforts to reform the system, inspired by Robert Triffin's early warnings about the instability of a global monetary system based on the US dollar (or any other national currency) [1] finally failed early 1970s. Instead of putting into practice the reforms agreed in the famous Committee of Twenty report [2], the main policymakers decided to abandon the idea of multilateral control of the system. From that time onwards, the world monetary system rested on two rather fragile pillars: a 'dollar-paper standard', rather than the previous dollar- gold standard, and floating exchange rates, instead of the previous fixed rates.

In the preface to this book, former Managing Director of the IMF, H. Johannes Witteveen, points to some of the weaknesses of the current system: serious volatility of exchange rates, dramatic swings in capital markets,

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1. See Triffin's "Europe and the Money Muddle" (1957) and his classic "Gold and the Dollar Crisis" (1960).

2. The Committee of Twenty (C-20), comprising representatives from the twenty member countries of IMF's Executive Board and chaired by Jeremy Morse, was established in 1972 by the IMF. In 1974, it presented the report "International Monetary Reform", outlining fundamental reforms of the world monetary system. The report was the culmination of more than ten years of discussions and negotiations between experts and officials of the ten major financial powers (G-10), the IMF and, after the establishment of C-20, the developing countries. The recommendations were not implemented; they were officially dismissed at an IMF meeting in Jamaica in 1976.