The 'Group of 30'—last chance for the SDR

In a remarkably frank luncheon exchange with reporters Feb. 20, spokesmen for the high-powered Group of 30—formally known as the "Consultative Group on Economic and Monetary Affairs"—proposed to put the American economy under the control of the Interntional Monetary Fund. Investment banker Robert V. Roosa, Princeton University professor Peter Kenen, and Brookings Institution fellow Robert Solomon called the gathering to promote the Group of 30's new report, "Reserve Assets and a Substitution Account: Towards a Less Unstable Monetary System."

The Group of 30's variant on the substitution account, a proposal which has been kicking around in international monetary negotiations for some years, has the International Monetary Fund taking over about $50 billion of unwanted dollar holdings of central banks, in return for paper valued in Special Drawing Rights. (The "Special Drawing Right," or SDR, is a "composite currency" composed of bits of the major trading currencies. Its present existence is strictly theoretical.) The International Monetary Fund would then use the dollars it absorbs to dictate terms to the United States.

According to Roosa, a former senior Treasury official and now a partner at Brown Brothers Harriman, "The substitution account will exert its own degree of descipline on the United States. By investing or not investing in Treasury securities, the IMF would place more powerful conditions on the United States than those existing in the market." For a government trying to finance a $91 billion (and probably larger) federal financing requirement in 1980, and with a collapsing bond market and an almost 20 percent inflation, this is powerful leverage indeed.

"Do you mean, IMF conditionality for the United States?" a reporter asked Roosa over dessert. The term "conditionality" refers to the IMF's power to impose cuts in consumption, currency devaluations, reductions in government spending and other onerous conditions on (mostly) developing-sector borrowers in return for credits. Conditionality is frequenty cited by Third World spokesmen to exemplify the imperialist abuses of the United States.

"Indeed, it becomes that," Roosa said through bites of a chocolate torte. "Ultimately, there has to be recognition of that on both sides."

The reporter persisted, "But, don't you expect some Congressman to get up and ask why the United States should be treated like some banana republic?"

"Yes. So what?," said the investment banker.

Paying claims with IOUs

According to the Group of 30's report, "The basic framework of a Substitution Account might be as follows: participants would deposit foreign exchange (initially dollars) in an account administered by the IMF, in return for SDR-denominated claims or 'certificates'; the managers of the account would invest the funds in securities or other assets denominated in dollars; the account would pay interest on the SDR claims and various arrangements would be made to ensure the full usability of the claims as reserve assets."

Since it was first suggested almost 10 years ago, the substitution account's rationale has been the need to eliminate the dollar as a reserve instrument. In the past, the United States has abused its reserve asset position by unloading federal debt on its European and Japanese friends, in order, for example, to finance $33 billion of Vietnam War expenditures on its balance-of-payments account. Carter's current defense and "energy independence" budget proposes roughly the same thing. This time, however, foreign dollar holders are not prepared to accept a second outrush of dollars, swelling and distorting their own currency arrangements. Therefore, the International Monetary Fund, and its private adjunct

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body, the Group of 30, have proposed to hand foreign dollar holders an SDR-denominated IOU, instead of dollars. Since the SDR's value is a weighted average of the major currencies in world trade, then presumably the SDR-denominated paper is less likely to depreciate, as the dollar has, against other currencies.

Since most dumping of dollars has occurred on the private, rather than the official side, of finance, then "the private sector should in time play a major role in promoting the objectives of the schmeme," according to the report. Professor Kenen said at the luncheon disucssion that this was the most important new feature of the Group of 30 document. The report states: "Although the usefulness of the Substitution Account would not depend upon the development of a private market in the SDR claim, it would be greatly improved by such a market."

The big hole in this argument is that the European, Japanese, and Arab monetary institutions which are supposedly the major beneficiaries of the Substitution Account scheme are less worried about the current value of the dollars they hold than about the basic conduct of American economic policy. Carter, after all, is not expanding the federal deficit to finance international trade, but to create a military autarky in the United States—which could only be viewed as beneficial to Europe or the Arabs in the most cynical possible light. Both the military and energy features of the Carter budget correspond to a strategic perspective that the Europeans, generally, consider lunatic. In effect, the proponents of the Substitution Account—including the administration and the Federal Reserve—have rephrased the argument thusly: "The instability of the American economy and the dollar threatens to destroy the world economy and take you with it. We insist on both a military buildup, and an inflow of dollars into the United States to finance it. We will enforce the relevant austerity upon the U.S. population through the International Monetary Fund, and demand that you support this as a matter of loyalty to the North Atlantic Treaty Organization."

Some shortage of confidence

It hasn't panned out this way. The French government has nominally agreed to a substitution account, but proposed—almost ironically—a "gold content" SDR, in which some weight of gold would be included in the make-up of this financial beast. Meanwhile, the France-allied Spanish finance minister, Senor Leal, told the chairman of the IMF's Interim Committee that Spain opposed the SDR arrangement on the grounds that it would drain liquidity from the international markets that was needed otherwise. (At the Feb. 20 session, Brookings fellow Solomon, formerly senior advisor to the Federal Reserve, predicted that Third World nations would raise the same objection.) In effect, the Spanish government told the Fund that it had no intention of permitting the Fund to take over liquidity that it otherwise wanted to use.

The chairman of the Interim Committee, Italian Finance Minister Pandolfi, is currently in Latin America, attempting to persuade Brazil and Mexico to throw their weight in the IMF's Third World caucus behind the Substitution Account. The Brazilians may, indeed, accomodate Pandolfi, who has one good argument to use with them: Brazil wants about $1.5 billion from the IMF as part of an overall 1980 foreign financing package that is expected to total $20 billion, according to internal Brazilian Treasury estimates. However, the Mexicans, whose own modest gold-mining capacity has encouraged them to lean toward gold remonetization, are not expected to give Pandolfi the time of day.

Too little confidence too late

Robert Roosa admitted as much in his introductory remarks: there is some shortage of confidence in the plan. At a similar press conference by the chariman of the Group of 30, former IMF Managing Director Johannes Witteveen, in London earlier that day, British reporters demanded to know how the Group foresaw the use of gold, Roosa said. The present study only suggests in passing that the IMF's remaining gold holdings be used in the event of liquidiation of the Substitution Account as a kind of banking capital for the Account.

The British press, like the London *Financial Times's* Eurocurrency market survey of Feb. 19, has warned that the principal way investors have of hedging against holdings of unwanted currencies is not to buy other currencies, but to buy raw materials or gold. Has the Group of 30 report on Special Drawing Rights come too late?

"I hope not," Roosa said. Kenen and Solomon, the other panelists, jumped in to explain that, in their view, gold could not effectively replace existing dollar holdings because if central banks all bought gold, the price would rise astronomically. (On the other hand, at a gold price of $700 an ounce or thereabouts, the most important central banks could comfortably *freeze* their dollar assets for a considerable period, and instead use gold or paper backed by gold, like the current European Currency Unit, to settle balances.) But Roosa waved his colleagues off.

"I have always opposed the sale of gold by the Treasury or the International Monetary Fund," he said. "I have been something of a maverick on this. It appeals to the mind of man as an ultimate source of capital. It is therefore useful in the unthinkable circumstance that everything else goes wrong."