

Sohmen, Egon

Article — Digitized Version

More Security in International Trade? Interview with Professor Egon Sohmen, of Saarbrücken University, on the proposal advanced by 27 monetary experts in favour of limited exchange-rate flexibility

Intereconomics

Suggested Citation: Sohmen, Egon (1966) : More Security in International Trade? Interview with Professor Egon Sohmen, of Saarbrücken University, on the proposal advanced by 27 monetary experts in favour of limited exchange-rate flexibility, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 01, Iss. 4, pp. 4-10,
<https://doi.org/10.1007/BF02933672>

This Version is available at:

<https://hdl.handle.net/10419/137606>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

More Security in International Trade?

Interview with Professor Egon Sohmen, of Saarbrücken University, on the proposal advanced by 27 monetary experts in favour of limited exchange-rate flexibility

INTERECONOMICS: Professor Sohmen, a group of 27 monetary experts of international reputation¹ recently put forward a proposal for flexible exchange rates within certain bounds. You are one of the signatories to this proposal. First, it is proposed that the limits within which individual countries are obliged to hold the gold equivalent of their currencies be extended; these limits should be increased from 1%—as hitherto—to 4 or 5% in each direction. The second proposal is aimed at permitting parity changes at the discretion of the country in question, insofar as such changes are not in excess of 1 or 2% of the previous year's parity. Professor Sohmen, could you begin by commenting briefly on these two proposals?

SOHMEN: As you say, the main idea is to make exchange rates somewhat more flexible. But I must add that the proposed reform would, in one respect, involve even less variability than is permitted now: it would only be possible to adjust currency parities by a maximum of 1 to 2% p. a., where-

as at present they can be adjusted by far more than 2% in one year.

INTERECONOMICS: By how much then?

SOHMEN: Members of the International Monetary Fund are at liberty to adjust parities by up to 10% of original parity. The only condition is that they inform the Administration of the Fund. When an adjustment amounts to more than 10% of the initially established parity, permission has to be obtained from the Fund first.

In practice, however, and for obvious reasons, this permission has not been sought in all important cases of parity adjustments; the Fund has been faced with a "fait accompli". Examples are the devaluation of Sterling in 1949 and the parity adjustments of the D-Mark and the Dutch Guilder in 1961. In this respect, the system now proposed by the 27 economists would only allow much less abrupt adjustments of parity than hitherto.

INTERECONOMICS: Can you tell us briefly what has prompted the 27 economists to make these proposals?

SOHMEN: Under the current system, it has generally been found impossible to achieve the so-called "magic triangle"—i.e. the simultaneous realization of price stability, balance-of-payments equilibrium and full employment—whilst maintaining full convertibility. In Germany, the main problem has long been to maintain price stability because, on the average, prices elsewhere in the world have risen more sharply than inside Germany. In other countries, such as the United States, the authorities have been forced to permit relatively high unemployment figures because there was no other way of bringing external payments into balance. All this entails not only difficulties for the countries directly affected; it usually becomes necessary also to impose drastic restrictions on the free flow of international payments and trade in order to avoid serious disequilibria in the balance of payments. One of the main objectives of the 27 economists was to bring about a system that is less prone to retard the integration of the world economy than the system now in operation.

INTERECONOMICS: So this is almost precisely the opposite of what is always feared by the majority of critics of these and earlier proposals in favour of more flexible exchange rates: namely, that this would be an obstacle to the international flow of trade and capital. The same view was taken by the German government at the beginning of 1965, in its comments on the first annual report by the Council of Economic Experts, to which the report on the question of flexible exchange rates—by Prof. Lutz and yourself—was appended. The initiative of the 27 monetary experts was commented upon by the German government in the same spirit. The Bundesbank and German business circles have argued along similar lines.

SOHMEN: The possibility that more flexible exchange rates might

EGON SOHMEN

is one of the international monetary experts who have for years urged a reform of the current international monetary system. Sohmen became known to a broader sector of the German public when—in conjunction with Friedrich A. Lutz, of Zurich—he submitted a supplementary report to the first annual report (1964/65) of the German Council of Economic Experts on the question of how to avoid imported inflation. In this supplementary report, Lutz and Sohmen concluded that the only effective cure was the adoption of flexible exchange rates. Professor Sohmen is a native Austrian; at 35, he already has a distinguished academic career behind him: in 1954, he graduated as Dr. rer. pol. at Tübingen; 1955/1958 Instructor of Economics at Massachusetts Institute of Technology, Cambridge, Mass.; 1958 Ph.D. at this institution; 1958-1961 Assistant Professor at Yale University; since 1961 Professor of Economics at the University of the Saar. Among other works, Sohmen has published: *Flexible Exchange Rates. Theory and Controversy*, Chicago 1961; *Internationale Währungsprobleme. Eine Einführung*, Frankfurt/Main 1964.

¹ List of signatories see next page.

have adverse effects upon the flow of trade and capital would naturally be a very potent counter-argument. I am convinced, however, that—in essence—this argument is only based upon misconceptions. It is true, of course, that at one time the majority of economists thought as well that fixed exchange rates would facilitate international trade and capital flows. Those who are now responsible for the conduct of economic policy merely reflect the views held by the leading economists at the time when they were students.

INTERECONOMICS: This, then, is a typical example of a timelag between scientific recognition of a fact and its adoption in practice?

SOHMEN: It is indeed. I believe that almost all economists who have thought these matters through agree that the view formerly held by economists rested on very superficial analysis and that it has not been corroborated either by modern theory or by practical experience. On the contrary: the fixing of exchange rates amounts simply to administrative price fixing on the foreign-exchange markets. It would be most surprising if officially fixed prices on the foreign-exchange market were to facilitate market adjustment and if it were to reduce the need for measures of exchange control. During World War II and thereafter we have had sufficient experience what are the consequences of price fixing by the authorities. An artificially fixed price is frequently not the equilibrium price. As a consequence, the authorities are often forced to intervene so as to regulate supply and demand in such a

market. If, on the other hand, the price mechanism is given free play, the correct equilibrium price will evolve and there will be no need for introducing official controls.

INTERECONOMICS: You mean official controls over and above the quantitative interventions by central banks on the foreign exchange markets?

SOHMEN: Precisely. Interventions in the form of central-bank purchases or sales of foreign currencies are only the instrument for influencing market prices. I was thinking of the fact that in a deficit country it often proves necessary to impose exchange controls in order to ensure that excess demand for foreign currency does not threaten to exhaust official currency reserves.

INTERECONOMICS: A very recent example is the United States where a poll tax on people travelling abroad was being discussed.

SOHMEN: Yes, it has only been discussed so far; it was never actually introduced. But—to keep to the United States—for almost two years there has been an "interest equalisation tax", which is aimed at limiting long-term capital exports by residents of the United States. In Germany, there is something similar with signs reversed: the recently introduced "Kuponsteuer" (withholding tax) on earnings from fixed-interests securities held by non-residents. In Switzerland, as in Germany, there are interest embargos upon bank deposits belonging to non-residents. The United Kingdom is still a long distance away from full convertibility for residents. For example, British residents are not allowed to buy foreign stock or other foreign assets at the official rate of exchange. They can buy capital investments abroad only at a freely fluctuating rate of exchange which, at the moment, lies about 20% above official parity. This means that England really practices multiple exchange rates in addition to very strict exchange controls on capital transactions. In the case of Sterling, it is quite grotesque to speak of convertibility.

INTERECONOMICS: Above all, when one thinks of the additional 15% special duties!

SOHMEN: Yes, the special duty imposed last winter upon the ma-

jority of industrial imports also acted as a strong brake upon the demand for foreign currency. Naturally, this measure interfered severely with the freedom of international trade.

INTERECONOMICS: All these official measures point up very clearly the susceptibility of the present system. Would a system of flexible exchange rates bring about any improvement in view of the international division of labour?

SOHMEN: If exchange rates were flexible, the flow of international trade and payments would certainly be less inhibited by administrative obstacles, special duties, taxes upon capital movements and the like.

INTERECONOMICS: Is it not true that such comparisons are nothing but hypotheses? The negative attitude of officials and men of affairs would rather suggest that practical experience—where there has been any experience—shows the opposite.

SOHMEN: I share the view, of course, that such a fundamental question should not be decided solely on the basis of purely theoretical and abstract considerations; practical experience must also be taken into account. What does it show? Official comments on the report by the 27 economists only assert that integration would be inhibited by flexible exchange rates. There is no mention of actual experience. In fact, experience shows that where exchange rates have been allowed to move freely there has been no indication of any disturbing effect upon international trade and international movements of capital.

INTERECONOMICS: Of what examples are you thinking?

SOHMEN: The Canadian example, above all. From 1950 to 1962 Canada had freely adjustable exchange rates without any official limits of variation. Over this period Canadian trade certainly did not develop any less favourably than before and the same was true of capital transactions. This does not appear to be very widely known. But the fact is that in the years immediately following the introduction of flexible exchange rates, the annual export and import growth rates in Canada were much higher than previously. The in-

¹ The signatories are Professors Wilhelm Bauer, Essen; Richard E. Caves, Cambridge, Mass.; Alan C. L. Day, London; William Fellner, New Haven, Conn.; Milton Friedman, Chicago, Ill.; Herbert Giersch, Saarbrücken; Gottfried Haberler, Cambridge, Mass.; L. Albert Hahn, Paris; George N. Halm, Medford, Mass.; Alvin H. Hansen, Cambridge, Mass.; Arnold C. Harberger, Chicago, Ill.; Hendrik S. Houthakker, Cambridge, Mass.; Bertrand de Jouvenel, Paris; Harry G. Johnson, Chicago, Ill.; Friedrich A. Lutz, Zürich; Fritz Machlup, Princeton, N. J.; James E. Meade, Cambridge; Allan H. Meltzer, Pittsburgh, Pa.; Lloyd A. Metzler, Chicago, Ill.; Fritz W. Meyer, Bonn; Tibor Scitovsky, Berkeley, Calif.; Cambridge, Mass.; Arthur Smithies, Cambridge, Mass.; Egon Sohmen, Saarbrücken; Ingvar Svennilson, Stockholm; Jan Tinbergen, Den Haag; Jaroslav Vanek, Ithaca, N. Y.; Michel Woltrîn, Louvain.

Due to postal delays, the signature of Prof. Wilhelm Bauer, Essen, Chairman of the (German) Council of Economic Experts advising on overall economic development, had not arrived by the publication date (February 20, 1966), so that first press reports spoke of only 26 signatories.

crease was even greater in the sphere of capital movements. After exchange rates were de-controlled Canada's capital imports rose by several times their previous average annual rate of increase. (I am thinking not only of speculative, short-term capital movements, but in particular of long-term movements.) While exchange rates were freely adjustable, Canada was the country which had the highest net imports of long-term capital in the world.

If anything is to be learned from this experience, it must be the con-

trary of what is always asserted in official comments upon our statement.

INTERECONOMICS: Is it not possible that other factors also brought their influence to bear in the Canadian example?

SOHMEN: I should certainly not want to maintain that this growth of trade and capital movements after exchange rates had been de-controlled was solely due to this de-control alone. There are always special factors, of course, and as a rule, it is very difficult to separate

the effects of each individual factor. In this case, for example, the Korean War broke out shortly before exchange rates were de-controlled and this alone would probably have entailed an increase in trade, particularly for Canada, which is a large producer of raw materials. But it is certainly impossible to draw from the Canadian example the conclusion so often heard in official comments.

INTERECONOMICS: But not necessarily the opposite conclusion either! And in addition, it naturally makes a difference if all countries or a large group of countries go over to flexible exchange rates, or if only one country does.

SOHMEN: Of course it is not possible to give a conclusive answer before such a system has been adopted by a large number of countries. But if people have no confidence in theoretical premises or in the conclusions to be drawn from the empirical experience of single countries, it will never be possible to test either one or the other of these theses. The only way to perform an empirical test is to introduce the system in a larger number of countries.

INTERECONOMICS: It has repeatedly been said, in this connection, that the introduction of flexible exchange rates would inhibit, in particular, institutional integration within the EEC. For example, insuperable obstacles would arise with regard to fixing common prices for agricultural produce.

SOHMEN: The fundamental question here is whether the regulation of the markets for agricultural produce within the EEC is really to be welcomed in the first place. I believe that a great deal of abuse is being done here in the name of integration. If it were really true that more flexible exchange rates would embarrass or inhibit the proposed EEC agricultural price system, this alone would make me an even more convinced advocate of flexible exchange rates. But I do not believe that this is really true. If a common market for agricultural produce is to be created, the essential measure is the elimination of trade barriers between the countries concerned. Even with complete flexibility of exchange rates there would still be a standard price for each agricultural product on the common market as seen

FLEXIBLE EXCHANGE RATES AN OBSTACLE TO WORLD-WIDE INTEGRATION

From the Opinion of an Official of the Bundesbank on the Proposal
of the 27 Monetary Experts

1. In connection with a general system of freely fluctuating exchange rates, the objection can properly be raised that this could lead to a considerable burden and inhibition being placed upon the international flow of trade and capital ... Hence, to achieve the desired improvement in the balance of payments equilibrium, probably a very heavy price would have to be paid in the form of an obstruction to the integration of world industry and trade ...
2. In passing, it should be mentioned that, in spite of the restrictions imposed, the freedom proposed by the Professors might strike right at the heart of the present system of reserve currencies ... It would scarcely be possible ... to amend exchange rate policy, as advised by the Professors, without affecting the existing reserve system throughout the world ...
3. ... How could we operate such a system of (even limitedly) flexible exchange rates and equivalences of exchange, given the inter-relationships of the EEC countries? ... Among themselves, the EEC countries would have to abandon this greater flexibility of exchange rates and could only permit their currencies to fluctuate ... jointly, vis-à-vis third countries. However, this type of joint fluctuations vis-à-vis the rest of the world could only be operated once the EEC countries had a joint balance of payments system and, above all, a joint currency reserve and joint foreign exchange policy ...
4. ... Certainly, a greater flexibility in exchange rates would considerably ease the balancing of disequilibria in the balance of payments. But is this really always so desirable? Would this not involve a considerable relaxation in the discipline imposed by the balance of payments? ... We should ... not cast off so lightly the disciplinary effects of the present system of exchange rates. On the contrary, we should make every effort further to improve balance of payments policies and monetary discipline within the framework of this system of international regulations.
5. ... According to the regulations of the International Monetary Fund, most member-countries are already allowed to pursue a more flexible exchange rate policy. But they do not make full use of this possibility ... This is obviously not only a problem of formal regulations of the International Monetary Fund, but possibly even more so of practical political attitudes of member-countries towards free exchange rates ...

*Dr. Otmar Emminger
(in Deutschlandfunk on 6th March, 1966)*

from third countries. Within individual countries, of course, prices for agricultural products would naturally change in the currencies of the countries involved, as exchange rates altered.

INTERECONOMICS: Would not certain technical difficulties arise precisely because of this?

SOHMEN: The daily calculation of corresponding equilibrium prices on the markets of individual member countries, or even of prices fixed by the authorities, would be a relatively simple task. I do not think this would present any essential obstacle to a common agricultural policy. But there is one more factor I should like to mention: If—as is at present envisaged—agricultural prices are to be fixed on the basis of a European unit of account (i.e. in current practice, the dollar), and if exchange rates are fixed, this would mean that in times when domestic prices tend to rise, only the prices of agricultural products would remain constant. It has always been my impression that the principal motive for the EEC agricultural market arrangements was to favour agricultural producers. But the real outcome would under present conditions be a continual deterioration of the position precisely of the agricultural sector. If exchange rates were flexible, on the other hand, and the problem of imported inflation could thus be eliminated in the EEC countries, it would be easier than it is under the current system to stabilize the prices of industrial goods, and thus the terms of trade between agriculture and industry.

INTERECONOMICS: Of course, the problem of inflation does not derive solely from imported inflation. There are domestic causes of inflation, too.

SOHMEN: Of course. And, as we know, in recent times these domestic factors have been more potent than outside factors in the Federal Republic. It was never been asserted that more flexible exchange rates could eliminate all our economic problems nor even the problem of inflation alone. It is obvious that it would be the task of the authorities to take whatever further measures are necessary to prevent prices from rising too steeply after flexibility of exchange rates has eliminated external sources of inflation.

INTERECONOMICS: It is one of the main weaknesses of the present system that—once there are inflationary tendencies in other countries—the more a country imposes price discipline, the greater the degree of inflation it imports.

SOHMEN: This is certainly beyond dispute. Perhaps I should also mention here that in the dialogue in Germany over the past few years this phenomenon of "imported inflation" has been described in somewhat over-simplified terms. The usual argument runs as follows: When prices are more

stable at home than abroad, the balance-of-payments surplus increases. This has the consequence that, when there is a fixed rate of exchange, currency reserves at the central bank increase. This has an expansive effect upon the volume of money. This is, of course, entirely correct. But I believe that the process of imported inflation and the measures necessary to correct it can be more readily understood when attention is called to the fact that, as a result of free trade in goods, there is an immediate tendency for domestic prices to adapt themselves to prices

FLEXIBLE EXCHANGE RATES INTRODUCE NEW PROBLEMS

From the German Government's Comment on the First Annual
Report of the Council of Economic Experts

The statement runs throughout this expert opinion that in a world less concerned with price stability than is Germany, the Federal Republic can only avoid the consequences for its own level of prices by adjusting exchange rates. The German Government has no hesitation in rejecting this view advanced by the Council of Economic Experts ... Until very recently ... however, it has always been possible to find ways—and it would be possible to find others in the future—of forcing back influences on domestic price levels, originating abroad, although eliminating them completely will not be possible, whilst remaining dedicated to, and even promoting, co-operation and integration both inside Europe and worldwide.

There are international engagements which stand in the way of any conversion to fluctuating exchange rates or even of numerous modifications of such rates ...

Even if the Federal Government were not under this legal obligation, it would not give up its defence of fixed exchange rates. Fluctuating rates would involve new problems which would be no easier to overcome than the tendency to import creeping inflation. If the Federal Republic considers price stability to be of greater importance than do other countries, the DM would have to be revalued continually if no interventions were made on the currency market to maintain a stable rate. This would be a very favourable situation for speculation. Not least because of the import of capital, the rate would rise to a level where no further increase could be expected. This level might rise so far that the current balance would be in deficit. Because of this, the German economy would become abnormally dependent upon fluctuating rate forecasts and speculative capital movements. If the Federal Republic wishes to remain free of such influences, at a free rate it would be necessary for the foreign exchange control authorities to impose controls on capital movements ...

In a world where the tendency is towards integration, fixed exchange rates are an integration factor, however incomplete this may be, taken on its own. In any case fluctuating rates open up an easy route to international isolationism, so that although the will to integrate exists, it will be destroyed if more serious difficulties arise.

For the EEC, and for Germany's relations with the other member-countries, fixed exchange rates are a necessary prerequisite of the intentions to integrate reaching beyond mere freedom of economic relations.

abroad when exchange rates are fixed. If the price of a certain article on the world market is equal to one dollar per unit, e.g., and if the exchange rate is DM 4 to one dollar, the equilibrium price for the same article on the domestic market would probably not be too far away from DM 4. If its price on the world market is rising, this alone will be a sufficient cause for its price to increase on the domestic market as well. So there is no need at all to refer to the monetary adjustment process, in other words, to the induced increase in exchange reserves, to understand the process of imported inflation. I should like to give special emphasis to this point because it is very often thought that imported inflation can be eliminated by monetary measures alone. However, it can easily be deduced from the example quoted above that it is entirely possible for domestic prices to rise even when the volume of money in Germany remains absolutely constant. It is therefore a mistake to believe that imported inflation can be eliminated by the artificial inducement of capital outflow or the prevention of capital inflow—quite apart from all the other objections to measures of this kind.

INTERECONOMICS: A year ago, and again now, the German government argued as follows: it stated that the problem of imported inflation could be eliminated by demanding that Germany's main foreign trade partners should "show restraint". What chance of success do you think such a policy has?

SOHMEN: The German government is to be commended for trying to influence other countries in this way. And I believe that, whatever monetary system is in force, the government and the Bundesbank should continue their efforts. However, we know that this appeal to "show restraint" has not been nearly as successful as it is generally represented. It also needs to be pointed out that not even in their own country have the German government and the Bundesbank always been as successful in this regard as they expect to be in other countries.

INTERECONOMICS: So you are somewhat skeptical about attempts to solve this problem by obtaining

the co-operation of central banks on monetary matters—whether informally, as at present, or based on rules laid down for domestic adjustment, as urged by the Group of Ten.

SOHMEN: As I said: We can all be in favour of attempts to achieve more international coordination of economic policies. Unfortunately, the impression is often given as if this were either impossible or less desirable when exchange rates are flexible.

INTERECONOMICS: So that the more flexible exchange rates which were called for in your statement should only be considered as an addition to the other measures already planned?

SOHMEN: Of course. Perhaps I can take this opportunity to say that—if only because of semantic difficulties—discussions of these matters often give the public a wrong impression. When we speak of flexible, or more flexible, exchange rates, this is by no means the same thing as unstable exchange rates. Flexible exchange rates are by no means wildly fluctuating and unpredictable rates.

INTERECONOMICS: ... although this has often been suggested! In reading comments by the German government or the Bundesbank on this subject (for instance, about a year ago, in the German government's reaction to the first Annual Report, mentioned above) the terms "fluctuating" or "unstable" exchange rates appear again and again.

SOHMEN: I do not want to suggest ill will on the part of the authorities when they speak of "fluctuating" or "unstable" rates. I think most policymakers are deeply convinced that flexible exchange rates are necessarily unstable rates. However—and this can never be stressed too much—it is absolutely within the power of governments and central banks to ensure, by the use of traditional monetary and other economic policies, that even completely flexible exchange rates remain very stable or even absolutely constant.

INTERECONOMICS: Professor Sohmen, our present system, the Bretton Woods system, also has a certain flexibility built into it. How do you explain that practically no use has been made of

this; on the contrary, all central banks have done everything to maintain a policy of rigid exchange rates?

SOHMEN: At the initial talks in 1944/45, before the International Monetary Fund came into being, most participants did indeed consider more frequent parity adjustments to be desirable. But at that time, no one had any experience with this system and it could not be known how it would work out in practice. There has now been ample evidence that under this system it is almost impossible to make frequent parity adjustments. According to the rules of the Fund, parity adjustment can only be considered if there is a "fundamental disequilibrium". Governments now always wait until there is a major disequilibrium. Whatever adjustment of parities then becomes necessary must necessarily be much greater than the minor adjustments proposed in the statement by the 27 economists, i.e., a maximum of 1 or 2% p.a. Since the Bretton Woods system was adopted, large adjustments of 5, 10 or more per cent had often to be undertaken. Naturally, such major changes have very serious effects upon the flow of trade and capital and are so prejudicial to the safety and predictability of international payments that it is easy to understand why governments and central banks are extremely reluctant to make too frequent use of such a "measure of last resort".

INTERECONOMICS: The "Articles of Agreement" stipulate that the cash rate of exchange may only fluctuate by a very small percentage on either side of parity, but that the forward rate may not deviate from this "by more than a reasonable amount". However, this means in practice: there is no rigid rule. Central banks can readjust the forward rate every day by means of their swap policy.

SOHMEN: Yes, it is quite correct that there are no rigid limits of variation for forward exchange rates. But anybody who is familiar with the working of the forward exchange market knows that it is absolutely unthinkable, when capital movements are free, for long-term forward rates to move very far away from cash rates. For as soon as the difference between forward and cash rates becomes

larger than the difference between short-term interest rates in the two countries, covered interest arbitrage between the two countries becomes highly profitable. Massive capital movements will take place in the form of covered interest arbitrage, so that the reserves of whatever country is in deficit rapidly become exhausted. Whenever large capital movements have taken place in the last few years, official comments have generally attributed this to international currency speculation. In fact, however, most of these transactions are not speculation at all, but completely riskless interest arbitrage which—as I have said—becomes worthwhile because the forward rate is allowed to drift too far away from the cash rate.

INTERECONOMICS: Since you have introduced the word "speculation" into the discussion: What is the outlook for speculation in a system of flexible exchange rates? Opponents of such a system have alleged that speculation would increase beyond all bounds. And a further question: The argument concerning almost riskless one-way speculation that is urged against the present controlled rates is also used as a counterargument against the second amendment recommended by you and the other 26 economists, i.e. the adjustability of parities.

SOHMEN: Here again—as I see it—this is mostly due to misconceptions. Most laymen regard it as self-evident that the more a price can fluctuate, the greater is the incentive to speculate. They are also convinced that all speculation is undesirable. The real world is quite different from this image. Wherever a free market price is allowed to develop, the expectations of speculators also play a part in the formation of that price. Thus, at any moment, a price develops at which currently active speculators consider further speculation to be unprofitable. Take the stock exchange as an example. On the stock exchange, market quotations are readjusted daily and even hourly according to the free play of supply and demand. Naturally, there is also speculation on the stock exchange. But speculation is less blatant and its effects are less undesirable precisely because, on the stock exchange, prices are allowed free play in

once

ELBSCHLOSS

always

ELBSCHLOSS

ELBSCHLOSS-BRAUEREI, HAMBURG

order to attain a proper equilibrium each day. On the other hand, were the quotation of an equity to be fixed by the authorities this would create an irresistible inducement to „destabilizing“ speculation whenever the equilibrium price strayed too far from the officially controlled price. Things are exactly the same on the foreign-exchange markets.

INTERECONOMICS: Professor Sohmen, particularly circles connected with foreign trade have objected that flexible exchange rates would introduce a considerable element of uncertainty into foreign trade dealings, in the form of allegedly greater currency risks. Is this fear well-founded, or is it again based on a misconception?

SOHMEN: Mainly the latter, I think. As a rule, businessmen are prone to argue as if only one variable changes whilst all others remain constant. They see the problem of greater exchange-rate flexibility only from the aspect of greater uncertainty as to exchange-rate movements, and they forget that when rates are allowed to move freely, other variables can remain more constant than they are at present.

INTERECONOMICS: Of which other variables are you thinking?

SOHMEN: For one thing, if rates were more flexible, it would be easier than it has been in the last few years to avoid restrictions upon international trade and payments. Hence the risk to exporters and importers arising from the unexpected imposition of special duties, quotas and exchange controls

would largely disappear. In addition, where exchange rates remain constant it is very often necessary to follow undesirably restrictive or (in other countries) undesirably expansive monetary and financial policies. A very good example of the first case was the United States from about 1959 to 1962. Unemployment figures occasionally rose up to 7% of the available labour force and the American economy was running at much less than full capacity. This also meant that German exports to the United States were smaller than they would otherwise have been. The greater certainty in making cost and pricing calculations which is believed to derive from constant exchange rates was in this case partially offset, if not overcompensated for, by the much greater uncertainty of the demand for German export goods in the United States. On the other hand, during the long years of "imported inflation", wages certainly rose more than they would have risen otherwise in Germany. As a result, costs within German export industries also rose more rapidly and to that extent compensated for much of the apparent inducement to export arising from the undervaluation of the D-Mark.

INTERECONOMICS: What about the actual currency risk?

SOHMEN: This is probably the most important aspect to be considered. It needs repetition that there are forward exchange markets and that those engaged in international trade can cover the exchange risk on these markets. Anyone who concludes an export transaction and expects to be paid for his exports in six months can

sell the proceeds he anticipates receiving in foreign currency on the six-months forward exchange market, at a rate known in advance.

INTERECONOMICS: It is often argued by exporters that hitherto it has been by no means certain whether the currency risk could always be covered on the forward currency market. Experience has taught that at certain periods it is not possible to cover this risk, for example, during the weeks immediately preceding the revaluation of the D-Mark in 1961.

SOHMEN: People are apt to forget that these are phenomena which have occurred in the present system of "adjustably pegged" exchange rates. Under this system, such phenomena indeed occur often. Experience gained under this system must not, how-

ever, be extended to a system of more flexible rates. With freely flexible rates, it would be practically impossible for the forward markets to collapse in the way they sometimes do under the existing system. Both forward and spot exchange rates would be completely free at all times to settle at the current equilibrium level. The reason why the forward exchange markets collapsed after the revaluation of the D-Mark was simply that the forward markets were not being supported by the central bank and that, in periods when parity changes are expected to occur under the present system, central banks are forced, either by administrative measures or by moral suasion, to prohibit forward dealings not directly connected with export or import transactions. When all forward currency dealings not directly connected with

commerce are thus prevented more or less successfully, commercial traders have no market partners to whom they would offer, or from whom they could buy, forward currency. This is why there is a great danger that these markets may collapse at such times. It is precisely this danger which could be avoided by the introduction of more flexible exchange rates.

INTERECONOMICS: To boil it down to a formula, could we say: the system you propose is, in reality, a system offering greater security for all involved. Whilst the present monetary system forces us to lock the stable door after the horse has gone, the system proposed by the 27 experts would prevent the horse ever getting out of the stable?

SOHMEN: Quite right. that is the essence of our proposals.

Towards A Behavioural Science of Market Research: The Challenge of Africa

*By T. L. V. Blair, Ph. D., London **

Market research in developing world areas faces the most challenging tests in its brief history. Development implies the transformation of society; new sights and sounds jostle crowds on Main Streets in Africa, Latin America and Asia. And, as researchers follow new products into these arenas of contact and co-operation, they encounter new problems and opportunities. At this early stage in the confrontation between African consumers and markets and Western manufactured products it is appropriate to review market research, theory and method and to illuminate those areas where our present assumptions and methods falter before the thrust of social and economic change.

Origins, Definitions and Interests

Market research emerges out of the needs, intentions, and impulses of Western social, economic and intellectual history. Market research definitions, especially in England, tend to describe "what it does", i.e. its empirical contribution to the resolution of specific problems put forward by business. Its functions being conceived of as directly, and simply, related to the performance of business activities that direct the flow of goods and services from producer to consumer.

* This essay is based on a paper given at The Annual Conference of The Market Research Society (Great Britain) at The Grand Hotel, Eastbourne, England. Dr. Blair is a sociologist and author of: *Africa: A Market Profile*, London: Business Publications Ltd., 1965.

Occasionally along the continuum of marketing activities, definitional emphasis is placed on particular functions. For example, one writer defines market research as "investigations made by firms or by research organisations on behalf of firms, to find out how well a certain product was selling compared to its competitors and what sort of person is buying it and why". Other writers stress the intelligence function of market research in clarifying and solving business problems. John Downham and his colleagues have emphasised the "provision of information—designed to help in the formulation and solution of business problems".

Market research today reflects these orientations and operates in several fairly distinct ways. It has the responsibility of gathering the facts, monitoring the behaviour of existing products, exploring ways to better existing products and to research new possibilities. It also assists by analysing the correlates of marketing decision making, i.e. those things that must be known about people and social processes in order to formulate and realise technical and commercial decisions.

To carry out these functions market research has selectively borrowed insights, methods, concepts and findings from the natural and social sciences, linguistics, and arts and humanities. In some areas of market research important tools have been fashioned from this exotic pot-pourri. However, we are