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## Going it alone towards stabilisation

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# Going It Alone Towards Stabilisation

Overall economic development within the Federal Republic of Germany is determined, to a large extent, by business activity and business trends abroad. On the one hand, the concentration of German exports in investment goods has made the German economy highly sensitive to investment activities and thus to exaggerations and disturbances of economic growth in those countries that are Germany's important trading-partners. On the other hand, the level of prices on the German home market is closely tied to price trends in the outside world, largely through the rigidity of rates of exchange. This has the effect, under the existing conditions of full employment and free convertibility of the German Mark, that as long as price levels abroad are rising more rapidly than in Germany, any attempt at stabilising the West German economy will fail, not only when Germany has a surplus in its balance of payments but also when the basic balance is in equilibrium or showing even a slight deficit.

The price level in the home market is influenced not only by the demand-pull effect of export surpluses, which also increases the availability of liquid funds, but also by direct interdependence of prices: first, rising import prices may raise the domestic price level; secondly, rising foreign prices enable the industries working for export to pass on to customers wage increases with greater ease than can do the branches of little export intensity. This may transform the export industries into "wage leaders" who set into motion a general wage-drive, either by trying to attract labour from other branches of the economy through the bait of higher wage offers, or by being willing to make relatively big concessions during wage negotiations in order to avoid any possible danger of strikes. And thirdly, it may be assumed that the greater "propensity to make concessions" of employers in the export industries as caused by rising export prices, will make the trade unions keener to call for wage increases exceeding those they would normally demand.

The German "Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung" (Council of Experts on Economic Development) has recently published its third annual report. The Council deserves great merit for having shown to a wide public the logical consequences of these facts, as they determine the possibilities of a policy of stabilisation, or of one of controlled expansion: to keep prices really stable, the German Federal Government would have to succeed either in "hardening" the Bretton Woods system in cooperation with all the other member states, or to build up other external defences for its internal economic policy. That is to say that unless full convertibility of the German currency is to be restricted, rises in the rate of exchange must be permitted.

In its latest report, the Council explains in detail the improvements that would have to be made in the system of Bretton Woods in order to stop "imported inflation" from abroad. But the Council is probably justified, when doubting whether a majority of the member states would be willing in the near future to accept the required rules, which necessarily would have to be rather strict. For there are many countries whose general public is far less inflation-conscious than that of West Germany, and in a case of conflict, they are much more likely to forgo a stable price level for the sake of full employment and free bargaining for wages. Since discussion provoked by its first annual report (1964/65) has shown that the introduction of flexible exchange rates of the German Mark is highly improbable, the Council has now outlined two alternative methods for building up external defences for an efficient internal economic policy. One is the "rising rate of exchange under medium-term guarantee", and the second is a "widening of the band of exchange rates with a limited upward adjustment".

This is not to discuss whether under aspects of economic policy alternative number two appears to be more operational than number one. But the immediate purpose of the two proposals is to deprive German firms competing directly or indirectly with foreign concerns, of their margin for price increases they have hitherto obtained through the rising price trend abroad; at the same time, it tends towards stabilising the import price level. The international competitiveness of the German economy would not be adversely affected by such measures, provided the policy makers adopt that kind of "concerted action" which had been called for already in 1965 and which would have to consist of

simultaneous and coordinated stabilisation measures, all following the same aim, which is to keep expansion under control. Costs at home would then no longer rise to the same extent as hitherto, as the exchange relations in terms of real value might remain unchanged. From this it follows that it is imperative to enter upon "concerted action" and "external defence" at the same time. Without the one, the other would lose its value.

Neither of the two systems of external economic defence for an expansion policy aiming at stability would, by the way, render it more difficult to further integrate the Federal Republic of Germany with the

European Economic Community and the world economy. Nor are they obstacles to reaching the more demanding comprehensive objective of "hardening" the international currency system. On the contrary—the proposed measures might be shown to operate successfully in the Federal Republic, thus proving that the apparent conflict between economic growth and a stable currency can, actually, largely be obviated. This again could strengthen the will of other countries to seek stability to such an extent that reciprocity in the interest of stabilisation policy were the common basis of action. Thus along an indirect road there would be reached what up to now seems to be inaccessible by a more direct route. *Wolfgang Michalski*

## COMMENTS

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### *Granting Preferences*

#### **Good Will and Many Difficulties**

Urged by the developing countries, the EEC Commission and the UN Conference on Trade and Development (UNCTAD)—as well as GATT—have now submitted their proposals for a new worldwide system of preferences. Although the EEC and UNCTAD projects appear very similar at a first glance, differences of detail should not be overlooked.

UNCTAD takes the view that a new system of preferences must at least guarantee developing countries the same advantages as do currently existing regional preference systems. As desired by the developing countries, it recommends the granting of general preferences by all industrialised countries, with no exceptions and without quantitative restrictions. On the other hand, the EEC Commission, which upholds more strongly the interests of industrialised countries and of certain sectors, would like to negotiate preferences product by product and, in addition, would like to limit the number of countries benefitting by arriving at an exact definition of the concept "developing country". It is true that UNCTAD proposes protecting particularly sensitive branches in industrialised countries, but in this case it would probably be the countries granting preferences which would have to apply for exceptions. This would mean that their negotiating position would be considerably less favourable than under the system they are proposing.

The main object of the preference system is to speed up the process of development and to reduce differences in standards from those of industrialised countries by promoting exports from developing countries. In no case shall preferences be retained permanently

for this reason. In order to prevent long-term distortions in international competition, the EEC is proposing that the lifetime of such a solution should be a maximum of 10 years. There is no such term set in the UNCTAD proposal. In view of past experience of development policy, a procedure such as this, which does not overestimate the effects of the new arrangement, should be absolutely realistic. The developing countries are given the possibility of intensifying their self-help, whilst the granting of preferences requires industrialised countries to take numerous further measures. These include not only additional capital assistance and the making available of technical know-how, but above all the acknowledgement of a new and worldwide co-operation. The days in which developing countries are encouraged with one hand, whilst with the other maintenance subsidies are paid to sectors of domestic industry, will soon be a thing of the past.

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### *British Import Surcharge*

#### **Seeking a New Solution**

When, in autumn 1964, the newly-elected British Government celebrated its entry into office by imposing a 15% Import Surcharge, it was hoped that this measure, whilst avoiding a general policy of domestic deflation, would speedily and effectively cut down on imports. According to Government prognostications, the Import Surcharge would reduce the country's imports by £ 300 million p.a. However, this estimate turned out to be much too high—we can say this in spite of objections against attempting precise quantitative predictions. Although the rate of increase of all imports affected by this Import Surcharge fell from 29% in