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Granting preferences: Good will and many difficulties

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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