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sequence is, that we have—so far—experienced a setback in the income-distribution. We know from the years following the mid-fifties, that imports of manufactures react very strongly to improvements in the income-distribution. The same

can be said of the import-effect of investments; it will gain weight more than proportionally while the boom approximates gradually full utilisation of capacities. I would therefore believe that once at its height, the boom will automatically

ensure the full effect of the acceleration of imports and of the reduction of exports; the extremely high surpluses we have today should not be seen as a long-term phenomenon. The year 1969 can already be the turning-point.

## Has the Federal Government an Alternative?

by Dr Hans-Jürgen Schmahl, Hamburg

Last August saw the brushfire of feverish speculation discounting a rumoured revaluation of the Deutsche Mark, thus demonstrating that a country like the Federal Republic, which carries great weight in the world's economy, will not be permitted to accumulate with impunity huge export surpluses over the longer term. Even though such speculation may have been the clear result of deliberate manoeuvres by one or the other of our trading partners in order to feather their own nests, the fact that such speculation is at all possible was symptomatic and not accidental. For a long period, it had been possible to explain extremely large export surpluses by citing the cyclical movement of the national economy, first as the "reverse side of the medal" called recession, later as its inheritance. But for over one year, the German economy has again shown steady growth, and even so, there has not been the faintest indication of these surpluses beginning to be run off. In order to eliminate the effects of all the possible accidental influences, the clearest picture will be gained by taking the average results for the months May to July, 1968. Their total export surplus amounted to DM 3,714 mn, only DM 181 mn lower than the corresponding surplus of 1967. There can therefore be no surprise that doubts are growing about the allegedly cyclical and transitory nature of such surpluses.

On the other hand, such arguments are usually countered immediately by the display of relatively narrow surpluses of the

German balance of international payments up to the end of July, that is, before speculation about a possible revaluation of the DM started. Indeed, the Federal Bank's net holdings of currency reserves had grown between the beginning of the year and the end of July "only" by DM 2,811 mn. And if to this is added the "basic" balance, i.e. this part of the balance of payment, which shows the overall total of all long-term capital transactions with those on current account—through trade, services, and transfers—, this shows a result that could not possibly attract any criticism: for the first seven months of 1968, this basic balance showed a net deficit of DM 409 mn. This reflects Germany's "Capital Export Miracle", by which the long-term net capital export to foreign countries, during the period under review, amounted to the huge sum of DM 6,128 mn. It could therefore be argued that German export surpluses, in so far as they have not already been compensated for by unilateral capital transfers to foreign countries, e.g. through development aid, remittances of foreign workers to their home countries, etc., have been financed to their full extent by long-term funds.

### Equilibrium of the Basic Balance Is Insufficient

This fact is frequently being used for arriving at the conclusion that there is no disequilibrium at all in Germany's economic relations with the outside world. It can easily be shown that arguing in this way discloses a definition of a state of equilibrium in international trade

and payments which is conceived too narrowly.

The narrowness in defining international equilibrium or disequilibrium, respectively, is based on the abstract clearing between some composite items in the balance of payments but not on the study of their composition. However, there is a great difference between two forms of "equilibrating" the balance of payments, say, in the one case by clearing a surplus in the balance of current transactions (export surplus of goods and services) of DM 15 billion against a money transfer deficit of about DM 6 billion and a long-term export of capital of DM 9 billion, or when exactly the same result is achieved by respective clearing operations between items of plus DM 8 billion and minus DM 6 and 2 billion, on the other side. The figures named in the first instance are those actually recorded in 1968, whilst the second, purely hypothetical composition of the balance of payments contains the approximate target figures suggested by the German government's tentative planning of economic developments up to 1972, extrapolated for 1968.<sup>1</sup>

The West German net outgoings of goods and services supplied to foreign countries during 1968 will be the equivalent of DM 15 billion, and only half of this amount is required for covering unavoidable deficits. The remaining half could have been

<sup>1</sup> This "plan" aims at achieving an external contribution (surplus of the balance of current transaction in overall national accounts) of 1.5 per cent of the Gross National Product.

consumed in Germany for improving our standard of living. This sum of DM 7—8 billion is more than 1½ per cent of overall home demand in West Germany during the current year. However, thinking along these lines would only be important in the longer term, but it adds to the weight of other arguments, which are used against a high surplus of the German balance of current transactions. One of these arguments has been emphasised by the Federal Ministry of Economics — it is the growing burden such surpluses place on the shoulders of our trading partners. German export surpluses perpetually claim for themselves part of foreign demand which could be used by the foreign suppliers. This leads to a slowdown in their own business activities, and as at present hardly a country in Western Europe suffers from overheated demand, this influence is felt to be an adverse factor. But in addition there are balance of payments aspects. The two countries with the big balance of payments deficits, the United States and the United Kingdom, have made it abundantly clear that they aim at cutting down to measure the gaps in their balances of payments, and eventually at transforming them into surpluses. Such endeavour, however, will be futile as long as a trading nation of West Germany's importance continues to show big trading surpluses on current account so that for merely wiping them out (by capital export, for example) a supreme effort is needed. However, this aspect in itself would not yet justify a revaluation of the DM.

#### **No Risk for Internal Stability**

Among the important problems which will be neglected if we confine ourselves to analysing merely the basic balance is also internal economic stability. If the balance of current transactions shows a high surplus, any mounting trend of domestic demand will lead to over-employment of the productive forces much earlier than otherwise. When available capacities are fully or almost fully utilised — as is not the case at present — a large external contribution may

be conducive to endangered internal stability. Not even the financing of such export surpluses by long-term capital exports will afford protection against this risk. Only if this method of financing reduces home demand correspondingly, this might have a protective effect, but such an assumption appears highly unrealistic.

A step of such far-reaching importance as changing parity relationships between the world's currencies may only be taken for imperative reasons, which may originate in the home economy or in the foreign trade relations of a given state. In the Federal Republic of the present day, there are no inescapable reasons originating from its home economy pressing for such a decision. On the contrary, there are many reasons which lead to the conviction that the stunting of economic growth by upvaluing the German currency is, at present, still insupportable. The outward effect of our export surplus upon foreign countries, moreover, was hitherto kept in bounds by big long-term capital exports. The speculative inflow of foreign currency, which took place in recent weeks, must not be used as a pretext for demanding revaluation. Finally, it has not yet been proved with certainty, nor can it be so judged, that the high surplus in the balance of current transactions, which is an independent problem to be assessed not only in connection with "compensating" capital movements, is actually a "fundamental" problem such as has been made out. Doubts are growing, but it still remains to be seen whether the mounting engagement of all the productive potentialities will strengthen the marginal trend towards further imports and, combined with a declining trend towards inflating exports, may not cut down to size the trade surplus. If that should prove to be the case, revaluing the DM would not only be unnecessary but prove to be a positive mistake.

#### **Will the Surplus Decline in Time?**

Conditions, however, might change in the future. It is, for example, conceivable that continuing econo-

mic growth in the Federal Republic might not lead to sufficient import growth and to a corresponding reduction of the export impulse for cutting down, in time and in sufficient measure, the surplus in the balance of current transactions. "In time" — this would mean before home production capacities are utilised to such an extent that export surpluses can no longer be absorbed without a rise in prices and production costs. This high degree of capacity utilisation is very likely to be attained already during 1969. Should high export surpluses coincide with strong home demand this would immediately put in jeopardy the equilibrium in the overall basic balance. For there is no doubt that the Federal Bank would counter such a situation by a credit squeeze connected with higher interest rates and a cutdown of capital exports. The hoary conflict between the divergent aims of home economics and foreign trade policies would break out afresh, and without doubt, the immediate double effect would be exaggerated demand coupled with basic balance and, very probably as well, big currency payments surpluses. This, naturally, is only true provided the surplus in the balance of current transactions does not shrink spontaneously and in sufficient measure through overemployment of Germany's productive resources. In this context, it must be underlined that Germany's extremely high capital export might do its part in keeping high also the German foreign trade surplus, for it is not at all unlikely that capital exports have a kind of boomerang effect, by stimulating the exports of goods by the creditor country.

The possibility can therefore not be excluded that, already in 1969, Germany may find itself in a position in which not only the surplus in the balance of current transactions will have been reduced only a little, but its compatibility with the aims of Germany's home and foreign trade policies will have decreased considerably. From a situation of this kind there are only two alternative ways out. Either the equilibrium in foreign

trade and payments (that is, the surplus in the balance of current transactions together with an equalised basic balance must not be much larger than the capital transfers to foreign countries) will be achieved by a change in the exchange rate, or by fostering internal inflation deliberately for purposes of adjustment. To be realistic, we have to expect that also under conditions of changed exchange rates, prices and costs will be adjusted upwards, at least in part; this seems inevitable because the stabilising effect will become operative only with a considerable time lag. This will be the case to an increased extent if the rate of revaluation is too low.

#### **No Alternative for the Federal Government**

Changing the rates of exchange need not necessarily mean a replacement of present parities by a new and fixed parity. It would, of course, also be conceivable that the width of the present margin of permissible parity fluctuations be increased beyond three-quarter per cent upwards and downwards. In our situation of perennial surpluses this would mean a *de facto* revaluation of the DM but the higher value could at any time be reduced within the permissible margin, if so desired or needed. It is also possible to introduce a completely free and flexible rate of exchange. The advocates of the latter argue that this enables its operators to avoid any disequilibrium in the international payments of a given state even in the short term. However, the rules and regulations of the International Monetary Fund permit only fixed rates of exchange, subject to marginal fluctuations, as mentioned, and it is evident that the German Federal government has not the slightest intention to abandon this principle. This means: should the Federal government plump for a change of the DM parity, this would certainly lead to a fixed higher rate of exchange, making the DM and DM prices more expensive to all foreigners.

Posing the alternative, revaluation, or adaptation of the German

economy by induced inflation, does not leave the constitutional authorities, including the Federal government and, *de facto*, the Federal Bank, with any scope for freely selecting the various alternatives. Both Paragraph 1 of the German Stabilisation Act<sup>2</sup> and (according to its interpretation during past practice) Paragraph 3 of the Federal Bank Act<sup>3</sup> pledge the government and all the other monetary authorities of the Federal Republic to maintain stable prices. However, the question has still to be answered whether there is a genuine alternative, in substance, in the apparent choice between a revaluation of the DM, and an adjustment of the German economy by deliberate inflation or, in other words, whether upvaluing the DM will really permit us to evade our economic adaptation by inflation. Doubts are raised in this context. Increasing the value of the DM will certainly make German export products more expensive for foreign clients and consumers but only to the extent that exporters do not try to allow for this by cutting their prices. The incentive to doing so is proportionately stronger in relation to structural difficulties which compel certain industries to rely on exports, without which they could not survive (e.g. the manufacturers of motor cars and shipbuilding). On the other hand, imports into Germany will become cheaper for German users and consumers through German revaluation only to the extent that foreign suppliers do not use the scope given to them for raising their own prices.

Such fears may be disarmed by choosing a relatively high rate of revaluation, but it will still remain problematic which effect the changes in price relationships will have on turnover, in other words, whether there is price-related elasticity of imports and exports. In cases of low elasticity, the

<sup>2</sup> Gesetz zur Förderung der Stabilität und des Wachstums der Wirtschaft, June 8, 1967; Bundesgesetzblatt (Federal Gazette), vol. I, 1967, p. 582 et seq.

<sup>3</sup> Gesetz über die Deutsche Bundesbank, July 26, 1957; Federal Gazette, vol. I, 1957, p. 745 et seq. In Paragraph 3, the Federal Bank is given the task "to secure the currency".

volume of exports will hardly be affected by the new currency rate, but the income from exports will rise. On the other hand, somewhat higher import volumes will cost slightly less than the lower former total. More or less extremist assumptions will even permit us to "prove" that the value of export surpluses might rise after revaluation, for it is always, and not very convincingly, argued that the compensating deficit on capital export account would be reduced by revaluation; and if this should indeed be so, it appears that revaluation as an instrument for restoring equilibrium in both inland and foreign economic relations ought to be judged as utterly useless.

#### **The Cross of Fixed Exchange Rates**

Actually, this would be true only under improbably unfavourable conditions, and the fact that this is theoretically possible means only that the ultimate effect of revaluation cannot be precisely foretold. (But is this not also the case with any other economic measure?) True, it cannot be denied that, though revaluation, on principle, appears to be a suitable instrument for achieving the desired aims, it will also have some undesirable side-effects, which affect especially those branches of the economy whose structure forces them to work with a high export share.

Even though individual trades and businesses may have to suffer great hardship, overriding economic interests must have priority. The crucial argument is that the German economy can remain an island of stability in the middle of a world little given to cherishing stability only on condition that Germany adjusts the gear ratio by which its economic impulses and energies are transmitted to the other nations, and this transmission ratio is the exchange rate of the country's currency. If there is a fundamental disequilibrium in international trade and payments, this only shows that it is high time for changing this rate. Within the framework of fixed exchange rates, this is an inescapable effect.