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## The disputed world currency system

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# ARTICLES

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## Monetary Policy

### The Disputed World Currency System

by Professor Dr Andreas Predöhl, The German Overseas Institute, Hamburg

For more than 25 years international monetary policy has been suffering from its inadequate beginnings at Bretton Woods. The Bretton Woods Agreement provided for free, but stable exchange rates without laying down rules of conduct for the states concerned. Free and stable exchange rates are however possible only if one of two conditions is fulfilled: either the rules governing gold currencies are adhered to, in which case any autonomous economic policy is excluded, or the economic policies of the states concerned are co-ordinated. An autonomous economic policy means variable exchange rates. Now the Bretton Woods Agreement provides for occasional adjustments in the rates of exchange in the event of long-term imbalances, but this does not affect the principle.

#### **No Return to Gold Currencies**

There can be no return to gold currencies after the protracted and progressively worsening world economic crisis of 1931 had destroyed the machinery for automatically adjusting the business cycle. The depression of 1931 no longer fulfilled its legitimate role of preparing the economy for another leap forward from the lower level to which it had fallen; it failed in this role because conditions no longer existed for an atomistic competition by way of price and wage changes. Instead, the economy became bogged down in a state of equilibrium with under-employment — a state from which it could be freed only by an active business policy.

A return to the gold standard would therefore mean returning to the state of affairs that prevailed before the world economic crisis — the very state of affairs from which we have emerged by actively intervening in the economic processes. No country in the world could afford to renounce a policy of steady full employment.

No less utopian would be an attempt to coordinate the economic policies of all the countries of the

world. The territories of the various countries differ too much in size and in their links with one another for any unified world economic policy to be possible. For the same reason another solution must be ruled out. It is the seemingly ingenious proposal, advocated by most theoreticians, to adjust balances of payments automatically by means of variable exchange rates. Not only does this suggestion conflict with the provisions of the Bretton Woods Agreement, but it also takes no account of the fact that a country's dependence on its foreign exchange rates varies considerably with its size and geographic position so that an automatic adjustment of the kind hoped for cannot be expected.

#### **A New Style of Integration**

In contrast to the monetary policy, the commercial policy has found the way towards regional integration. It has turned out that only in Europe have state frontiers caused a catastrophic disintegration of trade, affecting the most active and most sensitive exchange of goods between closely interlinked industrial countries, while the economy in the vast areas of the USA and the Soviet Union have remained more or less unaffected. The world economy is after all concentrically grouped around three industrial power centres to which must be added in most recent times the Japanese power centre. The exchange of like goods within these magnetic fields of industry is in much greater jeopardy than the exchange of complementary goods between the industrial nucleus and the periphery. The foreign trade of the USA, however large it may be in terms of the so-called world trade, is very small when compared with the huge turnover within the frontiers of its vast territory. The same applies, if to a minor degree, also to the Soviet Union.

What matters therefore is to restore to the European magnetic field the position which the American and Soviet fields have never lost. It was

precisely in Europe that there was a chance to bring about an economic integration on the lines of the European Economic Community. In this community it is a matter of a small number of sociologically related states, closely depending on each other, which stand to gain decisively from an economic integration. Mere free-trade solutions such as have been tried by the OEEC and subsequently by EFTA have proved inadequate to achieve a new-style integration. Only when European integration has been achieved, and only then, will the conditions have been created for a world-wide cooperation of the economies in the large regional complexes of states.

### **Cooperation in the Field of Monetary Policy**

Although international money policy has so far not followed this way it has nonetheless gone beyond the Bretton Woods solution. The International Monetary Fund created at Bretton Woods would never have been able to function, if the participating states had not remained in constant consultation and managed as far as possible to cooperate. This cooperation has become particularly beneficial since the most important industrial countries joined to form the Club of Ten, which is for ever intent on either preventing or repairing the damage by way of compromises or helping out with credits required by states that have run into balance-of-payments difficulties. Of primary importance in this connexion is the endeavour on the part of the Ten to provide international liquidity in order to enable the states concerned to gain greater latitude in adjusting their balances of payments.

The dollar-exchange standard on which the whole system rests has evolved from the system established at Bretton Woods. It was natural for the dollar as the leading currency to become increasingly the actual reserve currency. But this involves a risk, inasmuch as the system can function only as long as the USA is in a position to guarantee the conversion of the dollar into gold. The two-tier price of gold, by which the Club of Ten has separated official conversions into gold from the free gold market, has demonstrated that the system is capable of weathering even critical situations.

The most recent monetary conference in Bonn has proved the usefulness of cooperation within the Club of Ten. To revalue the Deutsche Mark would have had an unfavourable effect from an economic point of view. Revaluation and devaluation should never be undertaken unless it is to level out a disequilibrium that has persisted over a long period and cannot be removed in any other way. These considerations did not apply to the case under discussion. The catastrophic aggravation of the balance of payments disequilibrium, which was originally due to entirely different causes, had only occurred in the last hour as a

result of speculative capital movements in expectation of a revaluation of the mark. It was therefore merely a matter of a very superficial phenomenon, and there was not the slightest reason why the speculators should be rewarded and thus be encouraged to undertake similar operations in the future. The argument that it is not for the stable countries to adjust themselves to the unstable ones, but vice versa must be interpreted, not from a moral, but from an economic point of view. The deficit countries have over-all deficits because the fault lies with them; the surplus countries have surpluses only in certain sectors of their economy, and these are due to market conditions abroad.

The most important thing to realise is however that correcting exchange rates is tantamount to curing the symptom — an action that holds out no hope of a permanent cure; restoring the balance through internal efforts on the other hand is a step in the direction of a final solution of the currency problem. Nor can an all-round revision of the exchange rates by a new world monetary conference bring a permanent solution, if it is not accompanied by a mutual adjustment of economic policies, but to hope for such an adjustment on a global scale is a pipe dream, for it runs counter to the trend towards linking the world economy by regional arrangements.

### **Balances of Payments in Disequilibrium**

Whatever President de Gaulle's motives may have been, from the point of view of a lasting solution it is to be welcomed that France decided against devaluation. Devaluation would again have obscured the true causes of the imbalance and would have deflected attention from the need for the countries concerned to bring their economic policies into line with one another. A different question, which as yet cannot be answered with any certainty, is whether it is still possible for France to wipe out the deficit in its balance of payments by its own efforts or whether it has by now become a chronic imbalance which can be remedied only by drastic devaluation.

As for the disequilibrium in the British balance of payments, it is in the long run impossible to remedy the situation by adjustments to the exchange rate. The cause of the trouble lies not so much with the partially outmoded structure of the British economy as with the fact Britain finds itself occupying a place in the world economy which no longer corresponds to present-day realities. One important cause of Britain's troubles will disappear when it becomes a member of the European Economic Community. Britain has always been dependent on trade exchanges with the whole world, and it can best regain its place in international trade by way of regional integration. The Commonwealth has always been a makeshift

solution to which Britain has resorted only when its world trade policy has encountered difficulties. As a "world economy in miniature" the Commonwealth acted as a kind of safety net for the British economy when it was in trouble. Today, the Commonwealth is less than ever fitted to play this role.

As for the balance of payments of the USA, it is even less possible to correct it by adjusting the exchange rates. America's foreign trade, large though it is when seen as a share of the so-called world market, is only marginal when compared with the huge turnovers that take place inside the vast US territory. The devaluation that occurred during the world economic crisis has proved this sufficiently. The USA is well able to control its balance of payments. For proof of this it suffices to consider the important part played by long-term American investments abroad. The United States has only to curtail these excessive claims to enable the dollar to continue to function as a reserve currency and to guarantee its conversion into gold. For the time being therefore the Western currency system will continue to be based on the dollar.

#### **Establishment of a European Monetary Order**

This does not mean that in the long run the currency system should not be brought into line with economic policy. As in the case of the economic order, the reorganisation of the world monetary system is proceeding from the bottom upwards, by way of regional arrangements to a global order. This means that a European monetary system should be the first priority. True, it will not be possible to achieve a common European currency without first unifying Europe politically; but closer cooperation between the Common Market countries in the monetary field has already been set in train by the Club of Ten when they last met. If from these beginnings there should develop a true solidarity and unity of purpose, most of the difficulties now facing the Ten would vanish. In such an event only the large blocs would be left to confront each other, and these would find it much easier to reach agreement on how to adjust their balances of payments than the Ten find it now. The countries lying on the periphery of the world economy would in any case have to continue to depend on managed currencies for a long time to come.

Such a regional solution would admittedly have to be extended to beyond the present confines of the EEC. Seen from a regional point of view, the EEC offers only a partial solution as long as it does not also comprise the EFTA countries and, above all, Great Britain. It is well to remember that before the EEC we already had the European Payments Union (EPU), which comprised all the Marshall-Aid countries, that is all the members of OEEC. Within the EPU balances of payments used

to be equalised on the lines of the Keynes Plan — the plan which in Bretton Woods was replaced by the rigid White Plan. Under the Keynes Plan payments were settled via a clearing union, which in a relatively short time achieved the convertibility of European currencies, thus contributing materially to world convertibility. If it were possible to turn the successor of the EPU—the European Currency Agreement—into an instrument for closer European cooperation in the monetary field, there might be a chance to develop it into a European counterpart of the Federal Reserve Board even before the EEC has reached its full stature. Such a solution would even be helpful in extending the EEC area inasmuch as it would clear the way towards integration over a wider European field.

#### **Economic and Monetary Policy in Step**

What European cooperation would mean for the world economy was clearly demonstrated by the Kennedy Round negotiations. If these negotiations failed to achieve the decisive break-through to free trade it was above all due to the fact that the USA did not have a fully developed counterpart. The Trade Expansion Act represents an epoch-making turn in the American trading policy inasmuch as for the first time the American economy was integrated into the world economy. True, the Americans have always advocated free access to the markets of the world, but only on condition that their own economy was protected, an economy which was in itself partially like a world market. American protective tariffs, having fulfilled their educative purpose, had become largely superfluous, and the EEC for their part could have lowered many of their tariffs without great difficulties, for these tariff rates in their arithmetical mean were excessively high as compared with the rules of GATT.

Cooperation between equal partners could have led to a new kind of free trade, a kind that can be achieved only by way of regional integration. It is here that the monetary policy plays a vital part in that it largely determines an autonomous economic policy. As long as monetary policy reigns supreme over the currencies of the world, paying no heed to the requirements of trade, it will not achieve anything better than compromises. It will also stand in the way of complete European integration, which in turn is a prerequisite for the creation of a new order on a global scale. Trade and monetary policies have always evolved in parallel: in the liberal country the gold standard had its counterpart in a more or less large measure of free trade. After the collapse of the liberal world economy trade and monetary policies went their separate ways with the result that an orderly world economy ceased to exist. The way back to it leads through integration of trade and monetary policies on a regional basis.