

Iklé, Max

Article — Digitized Version

Aftermath of the currency crisis

Intereconomics

Suggested Citation: Iklé, Max (1969) : Aftermath of the currency crisis, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 04, Iss. 5, pp. 150-153, <https://doi.org/10.1007/BF02930116>

This Version is available at:

<https://hdl.handle.net/10419/138186>

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.

Aftermath of the Currency Crisis

by Dr Max Iklé, Zurich *

Last November, the Western monetary system found itself for the third time within a year in the grip of a serious crisis, when huge amounts of money began to move in expectation of a revaluation of the German Mark and a devaluation of the French Franc. Now, after these events, the question arises of how it was at all possible that rumours of an impending revaluation of the DM and a devaluation of the French Franc should have had such an alarming effect, although—as became clear later—the two governments concerned refused to change the parity of their exchanges. At their monthly meeting early in November, the heads of the Central Banks would have had an opportunity to clarify German and French monetary policies. Instead, a rumor was heard that the German Federal Bank favoured a revaluation of the DM, and this rumour spread like wild-fire across the whole world. A clear statement of monetary policy at the right time would probably have been enough to avoid altogether the acute monetary crisis of the second week in November. As it was, there streamed into the German Federal Bank foreign exchange to the value of DM 8,000 million, while the Banque de France suffered foreign exchange losses to the tune of DM 600 million.

The German Government decided to maintain the parity of the DM and, instead of revaluing, to change its taxation policy in favour of imports and at the expense of exports. At the same time the Finance Ministers of the Club of Ten were invited to come to Bonn for an urgent conference. All that emerged from that conference is the unpleasant fact that the free convertibility of exchanges, to which we owe the improvement in world trade during the last few years, was further restricted in France and in Great Britain with the result that confidence in the Western monetary system has been shaken. This means that all endeavours to integrate the world economy have suffered a severe setback. The most recent serious currency crisis has given rise to numerous questions and various conclusions which will be discussed in the following. The intention is to assess the decisions

taken and to reflect on the future of the currency system.

Parity Changes and Currency Speculation

Would it not have been better to decide last November on a revaluation of the DM and a devaluation of the French Franc, instead of adopting the Federal Government's proposal for a "Substitute"-revaluation and the French import restrictions and exchange regulations which severely limited the convertibility of the French Franc? As for the DM, the fact is that during the period from 1962 to 1966 the German price level lagged behind that of other leading countries by 5.6 p.c. This discrepancy is in itself not excessive. Differences in economic trends will always result in the cost of living rising more quickly in one country than in others, and this is bound to upset the balances of payments. A monetary system must be capable of coping with such developments. Currency reserves are there to bridge over such temporary deficits so as to gain time to carry out the necessary adjustments. If one were to restore the balance every time by changing the parity, currency speculation would forever be on the boil. Not until the financial world is certain that parity changes will only be considered as a last resort, will it be possible to avoid speculative movements of funds such as occurred last November. The mere fact that in 1961 the Mark was revalued while the Franc was repeatedly devalued greatly helped to set the short-term funds in motion and to cause the so-called "leads and lags".

Promotion of Capital Exports

In this connexion the question arises what policy can be expected of a surplus country. The most obvious remedy would be for it to stimulate long-term capital exports with a view to equalising the so-called "basic balance". But this presupposes an efficient capital market and a rate of interest which does not lie above the interest-levels prevailing in other countries. Such prerequisites did not yet exist in the Federal Republic before 1965, in contrast to Switzerland where capital exports have for a long time been

* Condensed version of a lecture, on February 5, 1969, to the European Union, Zurich Section.

helping to compensate for the surpluses in the balance of payments. It was only last year that the Federal Republic was for the first time in a position to export sizeable amounts of long-term capital. This may be due to the fact that the economy at home was not yet working to full capacity.

Should long-term funds be insufficient to restore the balance of payments, the policy must be to aim at exporting short-term money through the banking system. This mechanism functions in Switzerland almost automatically. In Germany the process was helped by the Federal Bank, which put dollars at the disposal of the German banks on a swap basis—a procedure which has been made easier by the international market such as it has developed in recent years. As a result, the currency reserves of the German Federal Bank have not greatly increased during the period from 1966 to the spring of 1968. It was only the short-term capital, which has since begun to move, that started the upward trend of reserves.

But equalisation via the money and capital market by itself does not suffice because capital does not necessarily gravitate to the deficit-countries which have the greatest need of it. Besides, to build up excessively large credits is not the right way to strengthen confidence in the currencies of the debtor-countries. For this reason it is advisable to aim at equalising the foreign-exchange balance as far as possible. Such a process of adjustment demands of the creditor-country the maintenance of the highest possible level of employment so that imports may be stimulated. It would however be too much to expect this process to be carried to a point at which it becomes inflationary.

On the other hand, one can expect from countries whose balance of foreign exchange payments tends towards surpluses that they will also avoid the deflation. The disturbances that were derived from the Federal Republic have their origin not so much in the differences of the cost of living or the price level but rather in the after-effects of the setback during 1966/67. The right remedy was therefore the overcoming of the recession. It would have been better, though, if a recession would have never been allowed to appear. Since the German balance of trade surpluses cannot be retraced to an extremely high export volume, a revaluation of the DM would not have been recommendable.

The somewhat artificial looking manipulation of the turnover tax, in favour of imports and at the expense of exports, may help to accelerate the process of adjustment. Its great advantage over revaluation is that it can be stopped more easily and that farm produce can be excluded from it. A revaluation would have upset the agricultural markets considerably, necessitating the expendi-

ture of some billions of Marks in subsidies to keep prices low. On the other hand, making imports cheaper will by itself not be enough to bring about the desired equalisation, unless steps are taken at the same time to stimulate home demand.

Fair Chance for the Franc

Another question is whether the French Franc has become ripe for devaluation as a result of the rebellion of last May. Last year's wage increases have caused the cost of living to rise by 5.3 p.c. by the end of the year. That is admittedly more than in most other countries. But considering the profound disturbances of the economy the rise is still within tolerable limits. If it is possible once again to right the economy, there is a fair chance to manage without devaluation. In this connexion the example of Italy may be cited. In the early sixties Italy experienced wage increases of 15 p.c. each in two successive years with the result that the Italian balance of payments for 1963 was also upset. There was generally talk at the time of the need to devalue the Lira. The Italian monetary authorities managed however to stabilise the situation in less than two years and today Italy shows again a comfortable surplus on current account.

A devaluation of the Franc, on the other hand, would have had a highly unfavourable effect on price discipline. The prices for imported goods would have advanced on a broader front, and French manufacturers would have adjusted their prices accordingly. The workers would not have been prepared to give up the fruits of their strikes. The price-wage spiral could thus have easily started, which would not have been without danger in a country that had for decades been accustomed to live with inflation. True, the cost of living will go up in any case because public enterprises will have to put their tariffs up. There is, however, a chance that price increases can be more strictly controlled than if the Franc had been devalued.

It would therefore be wrong to assume that General de Gaulle's decision, which had the support of a large majority in the government, was motivated by mere reasons of prestige. The French government, conscious of its responsibilities, chose the more arduous way of combating inflation and, in so doing, has perhaps made a valuable contribution towards stabilising the monetary situation. A massive devaluation, such as had been considered in certain circles, could on the other hand have had incalculable consequences.

The Wish-Dream of a Monetary Union.

In view of the fact that the most recent monetary crisis occurred mainly within the EEC it is understandable that the question should have been raised as to whether it would be desirable to

strengthen monetary cooperation within the EEC by creating a monetary reserve pool or even a monetary union. Monetary crises such as the one of last November and the currency controls imposed by France threaten integration within the framework of the Common Market.

In the face of such far-reaching plans as the proposal for a monetary union it is advisable to preserve one's sense of sober realism. Different countries cannot have a common currency as long as they are not prepared to coordinate their economic policies. Experience has shown however that this cannot be achieved without a central authority. Experience has further shown that integration in the sphere of monetary policy is possible only after political integration has taken place. Even the strongly integrated Benelux-countries have never seriously considered taking the step towards a monetary union.

Things are not much different in the case of a currency pool within the EEC, which would automatically grant members the right to draw on the common reserves. Solutions of this kind are not suited to strengthen monetary discipline. It is difficult to imagine that countries which are determined to fight inflation within their own frontiers would be prepared to grant their less disciplined partners such facilities. Dr Emminger of the German Federal Bank recently declared that as long as there are countries which are prepared to put up with price increases of 5 p.c. while others have committed themselves to a rate of monetary depreciation of at most one per cent, there can be question of neither a monetary union nor a currency pool.

In Favour of Stable Exchange Rates

The three most recent currency crises have naturally given rise to the question as to whether the present monetary system is not in need of revision. The only alternative so far suggested is the proposal to allow the exchange rates to fluctuate within broader limits. Swiss monetary policy is committed to the principle of stable exchange rates. On the basis of a stable currency Switzerland has built up an efficient export industry, an international insurance business, a world-wide chain of trading companies and a financial centre—enterprises which converted natural poverty into prosperity. There is therefore in Switzerland not a minister of finance or commerce, no Central Bank head, no industrialist, no insurance broker, no banker who has any sympathy with a system of fluctuating exchange rates. It is interesting to note that in this field there exists a wide gap between theory and practice. But one thing must be strongly stressed: Stable currency rates contribute in an important manner to the integration of the Western economies, whereas fluctuating exchange rates have a disintegrating effect.

Flexible exchange rates and frequent changes of parity are also liable to encourage speculation. Without the frequent Franc-devaluations and the revaluations of the Mark in 1961 the massive movement of funds which took place last November would hardly have occurred. That the Swiss Franc did not get into the line of fire of the speculators is without doubt due to the fact that in 1961 Switzerland did not follow suit when the Mark was revalued.

Euro-Market in Jeopardy?

On the basis of stable exchange rates an international money market has developed in recent years—the so-called Euro-Market, whose turnover is presently estimated at roughly 20 thousand million Dollars. It is by way of this market that short-term funds flow from the banks of the surplus countries into the banks of the deficit countries. This market has helped in recent years to mitigate all unfavourable effects of upsets in the balance of payments and to preserve central-bank reserves. In this manner it has become a source of international liquidity without any help from official quarters. On this market bank advances are made for periods of one to six months at high rates of interest and at a fixed rate of exchange. The exchange fluctuations which still occur even within a system of stable exchange rates oblige the banks to safeguard their investments. In a system of flexible exchange rates the cost of insuring against the risk of exchange fluctuations would in all probability rise, which could easily make such operation unattractive. The danger that the Euro-Money Market may collapse under a system of flexible exchange rates is too great for the monetary authorities to embark on such a system.

Adequate Liquidity

It must be recognised, on the other hand, that no country can year in year out keep its payments in balance. Business will always fluctuate, and as these fluctuations will never coincide in the different countries, temporary surpluses or deficits in the balances of payments are unavoidable. For this reason members of the monetary system require reserves to tide them over deficit periods. Thanks to the cooperation among central banks, the stand-by credits of the International Monetary Fund and, most recently, the Euro-Market, funds can be placed at the disposal of a country in deficit to tide it over a difficult period even if that period should extend over several years. The present monetary system is therefore not wanting in liquidity or flexibility. The note-issuing banks have proved in recent years that they are prepared and able to direct liquid funds anywhere they are needed. If in future international liquidity should prove to be insufficient, there is still in reserve the system

of the new drawing rights within the framework of the International Monetary Fund. By the spring of 1969 the most important countries should have ratified the agreement so that the system can be put into operation as soon as the need for it arises. What is urgently required today is not increased liquidity but the restoration of confidence in the various currencies of the Western monetary system and thus in the system as a whole.

Reason for Modest Optimism

The system of free convertibility of currencies at stable rates within the framework of the gold-exchange standard has only been in existence for ten years. At the beginning of this period the consequences of the Second World War had by no means been overcome. During the war Great Britain had shouldered an onerous debt burden. The European capital markets were not yet functioning efficiently with the result that there was a one-way flow of capital from the USA to Europe, and this flow went a long way towards burdening the American balance of payments. The international political situation obliged the West to build up a defence system whose cost in foreign exchange was pretty unevenly divided. And yet the system has successfully weathered severe crises.

Against the grey background of these recent monetary crises the following facts begin to appear in outline—facts that justify some modest optimism:

☐ In the course of the ten years of convertibility valuable experiences have been made, and cooperation has started in the field of monetary policy—cooperation such as never existed before.

☐ In Europe a capital market is being created, which last year showed its great efficiency. The one-way traffic of capital would thus appear to have come to an end.

☐ In Europe there has come into being a money market, capable of directing short-term funds to wherever they are needed.

☐ The Franco-American tension over monetary policy seems to have been overcome.

☐ Britain's problem of its foreign holdings of Sterling has been to a large extent solved.

☐ The currency reserves are today better distributed among the most important countries than was the case at the end of the Second World War.

☐ The surplus countries are conscious of their responsibility and are showing their willingness to cooperate.

☐ The leading currency of the Western system, the Dollar, has proved to be a strong support in all crisis situations and that in spite of the fact that American gold holdings have been halved. There has been a return of confidence in the Dollar. For the first time since 1957 the American balance of payments showed a surplus last year, and this surplus was mainly due to capital movements.

Guided by past experience, work can continue on the basis of what exists already—the work of further integrating the economies of the West through stable exchange rates, stricter discipline in monetary matters and cooperation between the monetary authorities.

Stable exchange rates and the convertibility of currencies have already led to a far-reaching division of labour and thus to a more integrated world economy. To preserve these gains must therefore be the primary aim. Time is by no means ripe yet for a monetary union or a new European currency. There is little point in holding monetary conferences, even at the highest level, as long as no one can propose a workable alternative.

ERNST RUSS

Shipowner & Shipbroker

Agencies & Insurance

Established 1893

Hamburg 36 · Alsterarkaden 27

Phone: 36 12 71 Telex: 02 14 435

Cables: REEDERRUSS

Worldwide trading including North Sea and Baltic with own tramp-vessels

Own liner services from Hamburg to Finland and West Norway and from Benelux-Ports to Sweden

Liner agents for Finland, US-Gulf and Canada/Great Lakes

Worldwide Chartering

Speciality: Tanker- and Reefer-Chartering

Purchase and sale of ships