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Stability through revaluation

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Stability through Revaluation

Interview with Dr Otmar Emminger

Member of the Board of Governors of the Deutsche Bundesbank

QUESTION: The German Government decided to let the D-Mark float for a limited period. Did this decision intensify the discussion about flexible exchange rates at the recent Annual Meeting of the IMF?

ANSWER: Yes and No. The decision of the German Government of September 29 was greeted at the Annual Meeting in Washington with relief and often expressly welcomed. Everybody acknowledged that in this way a new wave of speculation about the D-Mark and its harmful effects on other currencies have been prevented. Some advocates of greater flexibility in the exchange rate system attach much more significance to this German measure: They believe that this example, given by a major currency, has demonstrated to the whole world that a necessary adjustment in the exchange rate can be achieved by allowing the rate to fluctuate or float over a certain period, and that this can be done without exposing the exchange markets to sudden shocks or other disruptions. By pointing to the successful German experiment this group of observers has tried to strengthen its case for more flexibility and to deflate the usual prejudice against more flexible exchange rates.

On another group of participants in the IMF meeting the floating of the D-Mark seemed to have rather the opposite effect: They came to the conclusion that now the discussion

about a more flexible exchange rate system is no longer as urgent as before. Probably it has not been fully realised in Germany that the international debate about the relaxation of the exchange rate system—at least as far as official government circles are concerned—has to some extent been nothing but a reaction to the distortions which the international monetary system suffered because of the stubborn refusal of France and Germany to adjust their exchange rates to reality. This has led people to explore possibilities for opening a way out of this rigidity and for avoiding any recurrence of similar situations in the future. Sometimes it has even been claimed that the interest taken by American officials in a more flexible exchange rate system originated primarily in their desire to see the German parity changed. This is certainly a one-sided and exaggerated view. There are, however, some indications that the upvaluation of the D-Mark will make a relaxation in the exchange rate system appear at least less urgent for a number of those government officials. In the monetary sphere it is even more true than anywhere else: innovations are often accepted only under the pressure of an acute crisis.

QUESTION: Contrary to the IMF the Commission of the European Communities has criticised the decision of the German Government and its proposed agricultural measures as well.

Didn't the Federal Republic pay an excessive price with the loss of confidence it suffered in the Common Market and the neighbouring countries as a result of the floating of the D-Mark?

ANSWER: It is true that the European Commission has criticised the measures the German Government took for the protection of German agriculture; it even wanted to have them removed or at least replaced by quite different measures. Thanks to the intervention of the Ministerial Council of the European Communities a compromise could be found. The Vice-President of the Commission, Prof. Barre, objected to the temporary floating of the D-Mark because freely fluctuating exchange rates are thought to be incompatible with the economic union and especially with the agricultural regulations inside the Common Market. Prof. Barre and the Commission feared that the floating of the D-Mark would not be limited to the short transitional period until a new German Government had been installed, but that it could forebode a more permanent floating of the exchange rate, and they also feared this example could be copied by other countries. When the Ministerial Council of the Common Market met on October 6 in Luxemburg some misunderstandings were cleared up by the German representatives. In particular it was made clear that the floating would definitely be only a transitional system

which would be replaced by a new D-Mark parity as soon as possible. Thereupon the Council expressly stated that it fully recognises the circumstances which forced the German Government to temporarily float the D-Mark; in view of the exigencies of the situation this was considered "the lesser evil" as compared with the likelihood of another monetary crisis. At the same time, however, it was stated that a permanently floating rate would be incompatible with the European Economic Communities. The finance and economic ministers of the other Common Market countries attending the Ministerial Council meeting all commented positively on the German decision as a temporary solution. Therefore it cannot be pretended that this amounts to a "loss of confidence". Quite to the contrary:

Since an immediate unequivocal decision in favour of a revaluation of the D-Mark could not be achieved under the prevailing circumstances, any other measure than the one actually taken would indeed have meant a loss of confidence abroad for the Federal Republic.

QUESTION: The de jure-revaluation of the D-Mark has now followed this first step. Many experts are of the opinion that it has come too late by at least six months. Can the danger of an overheating of the German economy still be prevented by the revaluation of the D-Mark by 8.5 p.c.?

ANSWER: Some months ago I already stated in a newspaper interview that the best moment for a revaluation had been missed. With a timely revaluation the overheating of the economy and the strain on the

labour market would certainly not have assumed such extreme forms as they actually have in recent months. We would have been spared a good part of the present dangerous wage and price explosion. But this does not mean that an up-valuation of the D-Mark does no longer make sense. The decisive question is to what extent the actual and impending cost increases will be passed on to higher prices. Since prices have very much risen abroad over the last year, in many areas foreign competition is no longer such an effective brake on prices as it used to be. By revaluing the D-Mark and thus making foreign goods cheaper this brake may become a decisive factor in dampening down price inflation at a crucial moment for the domestic stability of the Federal Republic.

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by Klaus Beplat

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