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## Monetary system remains susceptible to crises

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## Effects of the DM-Revaluation

The decision of October 24, 1969, to revalue the Deutschmark was the first economic policy measure taken by the new government in Bonn. The following articles analyse the future probable effect of the revaluation upon the international currency situation and the German economy.

## Monetary System Remains Susceptible to Crises

by Dr Hans-Eckart Scharrer, Hamburg

**W**ill the dosis of 8.5 p.c. revaluation of the Deutschmark act as an effective remedy to ward off any relapse into further bouts of international currency crises? An optimistic answer to this question might have been gained from the commentaries on the decision of October 24 last to change the German exchange rate, coming from official quarters and officially-inspired sources abroad. Whitehall came to the conclusion that a (mathematically indicated) further improvement of the British balance of trade by between £60 and 70 mn would be its effect, France already believed in the Franc's recover, and the State Department in Washington opined that

the chief cause for uncertainty in the foreign currency markets had now disappeared. As much as we may be inclined to concede a peaceful interval to the exhausted crisis managers in the central banks and national ministries of finance and economics for drawing breath, careful examination of the new currency situation must give rise to serious doubts in the capacity of the German reform to meet all the high hopes connected with it.

### Danger of New Speculation

The gradually widening price and cost gap between the Federal Republic of Germany and the rest of the world, which had reached about 9 p.c. since the

last revaluation of the DM in March, 1961, will have disappeared, on average, since the second revaluation. But as the administrative and fiscal measures taken before actual revaluation took place, and known as "revaluation surrogates", had clearly shown, the effect of this difference in price and cost levels on foreign trade developments is very limited. It may therefore be anticipated that up-valuing the DM will reduce the surplus on goods and services account by only DM 0.5 bn to about DM 14.5 bn in 1970<sup>1</sup>. As it had mainly been this invariably high surplus which had given

<sup>1</sup> cf. Hans-Jürgen Schmahel, *German Economy Not Imperilled*, p. 378.

rise, again and again, to expectations of DM revaluation, it will not at all be impossible that, after some time, the Federal Republic will again become the haven sought by speculative money transfers. This risk is obvious because the exceedingly high long-term net capital outflow of DM 11.5 bn in 1968 which, up to now, had absorbed the surplus on German current account will certainly be reduced in the future. One of the most powerful sources of these capital exports was the plethora of liquid funds in the hands of the banks. An estimated DM 10 to 15 bn of foreign deposits have gradually left Germany, and as the Federal Bank continues its credit restrictions, the overliquidity of German banks will soon be a thing of the past.

#### **Franco and Pound Still Under Pressure**

The other way round, a similar uncertainty is to be registered in countries with deficits. The international position of the French franc, in spite of its devaluation by 12.5 p.c. and of the full use being made of the IMF credit lines granted to France, has not yet firmed up convincingly. The lack of confidence in the Franc, which will not be overcome by the revaluation of the DM which the French government has already accounted for, is basically caused by the instability of the French home situation. The Chaban-Delmas government has not yet succeeded in mastering the prices and wages spiral, and the possibility of new and fierce industrial strife may still be anticipated. On top of all this comes the pressure for higher prices and costs induced by the DM revaluation, since almost a

full quarter of all French imports originate in Germany. The danger of pressures forcing the French government into further devaluation measures is not yet past.

Should it come to such a step, this would also gravely undermine the position of the English pound, which is being held stable only with the utmost endeavour. Both in the spring of 1969, when the franc passed through a crisis, and at its eventual devaluation in August, the pound had been able to weather the storm only with the aid of further shoring up through foreign credits. Since then, the Labour government's austerity measures have reaped their first successes: In August and in September, the British balance of trade was in surplus for the first time for a long period, for £40 mn and £26 mn, respectively. Surpluses in the balance of current transactions, during the second and third quarters of 1969, even went up to over £200 mn. Possibilities for further growth of British exports to the important German market and to other countries have again improved through DM revaluation, but it is certainly too early to predict a durable recovery of the pound and the achievement of its immunity against the fluctuations of speculative funds, at the present juncture. On the other hand, we are entitled to expect that the pound in itself will no longer be an element of disturbance in international currency markets.

#### **The Dollar as Disturbing Factor**

Another currency, however, whose decisive importance has almost been forgotten since the

gold market has been divided into two sections may well become such a disturbing factor — this is the US-\$. Though growth of the US GNP has slowed down further to 1 p.c. p.a. only in real terms, whilst unemployment rose to 4 p.c. and both monetary and fiscal policies remain sharply restrictive, the deficit on foreign payments account has beaten all previous records during the second quarter of 1969 in reaching an annual rate of \$15.2 bn, as against only \$6.8 bn in the first quarter. Admittedly, this dramatic change is partly due to purely technical causes—the peculiarity of the US balance of payments statistics which apply the "liquidity concept"—but in the main, the disastrous downturn was induced by the highly unsatisfactory development of foreign trade which persists: during the first six months of 1969, US net exports earned only \$150 mn. The weakness of US exports generally reflects the fact that the dollar is overvalued, and this will scantily change after the revaluation of the DM. Yet it is not at all certain that the deficit on the United States' foreign payments account will lead to further speculation against the dollar. Since the creation of the two-tier gold market in March, 1968, central banks have given up insisting on converting their dollar holdings into gold, which means that they have accepted the abandonment of the gold standard and an effective establishment of a dollar standard. For the time being at least, one of the major disturbing influences has thus disappeared.

As the DM revaluation can necessarily make only a limited contribution to other countries'

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overcoming their balance-of-payments problems, the system of international currencies will consequently remain permanently prone to crisis. Therefore, it ought to be welcomed that the Federal Republic of Germany, by deciding in favour of revaluation, has newly revived worldwide currency cooperation. It has again demonstrated, in a most impressive way, that surplus countries, too, have to abide by the rules of the game imposed on at Bretton Woods. As a matter of fact, these rules, which offer nations the choice between a change in their currencies' exchange rates and an adjustment of their domestic economy, apply not only to countries incurring a deficit. The international division of labour can operate optimally only on condition that all the im-

portant nations, through their economic policies, contribute to multilateral equilibrium.

### **Greater Flexibility of DM Desirable**

It is, however, to be regretted that the Federal Government did not see fit to opt now for greater flexibility of the DM's rate of exchange. In fact, Bundesbank Director Dr Emminger's proposal<sup>2</sup> of varying the currency's international exchange value, at the government's discretion, in small steps<sup>3</sup>, would not violate the rules of the IMF, since such a system leaves open the possibility to consult with the IMF each time such a step was envisaged. That the Government hesitates before it makes up its mind to leave the path of international uniformity in using fixed

exchange rates over the long term can only be explained by its consideration to its obligations under Common Market agreements. But after the changes in the French franc's and the Deutschmark's exchange rates have highlighted the absurdity of existing agreements on prices for farm produce, governments find themselves facing the new task—and the chance—to look for new designs of groping for institutionalised integration, which will stand the test of future times. To enable the world to work for orderly progress in the development of the international currency system, it appears desirable, in particular, that new plans will be drafted to serve the overall purposes of coordinating national economic policies and of creating a common European currency, in preference to partial solutions touching only certain sectors of the economies.

<sup>2</sup> Otmar Emminger, *Das Wechselkursystem auf dem Prüfstand* (The System of Exchange Rates on Test), in *Euromoney*, August, 1969, as reprinted in the German Federal Bank's Press Digest (Auszüge aus Presseartikeln), No. 63, Aug. 22, 1969.

<sup>3</sup> In its basic characteristics, Emminger's model follows the "system of limited flexibility by graduated steps", which had been suggested already in 1962 by H. Lipfert and R. Wittgen.

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