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# German Economy Not Imperilled

by Dr Hans-Jürgen Schmahl, Hamburg

Since October 27, 1969, the DM has been revalued not only actually but also formally. Already on September 29, still under the Government of Herr Kiesinger, the old DM-exchange rate had been suspended due to the overwhelming pressure of the market forces — disqualified as “speculative” by the opponents of revaluation. The exchange rate of the DM began to rise immediately, i.e. the amount of DM to be paid for one US-dollar fell below the lower intervention point of the old parity of DM 3.97. The rise of the exchange rate was once more promoted, when on October 8 the export tax and the import remuneration were suspended and, simultaneously, it was generally anticipated that they would soon be abolished. On the last day of quotation before the fixing of the new parity the official exchange rate at Frankfurt was approx. DM 3.70 per dollar. The new parity was fixed at DM 3.66 per dollar. Depending on the method of calculation this means a DM-revaluation of 8.5 p.c.—for Germans the price of foreign currencies is reduced by this rate—or of 9.3 p.c. — this is the rate by which the price of the DM increases for foreigners.

## The Road towards a New “Equilibrium”

The rate of revaluation is slightly higher than had frequently been expected. These anticipations had obviously been determined by the exchange rate realised in the last phase of the relatively free process of settling

down at a new level — for the Federal Bank had only very cautiously intervened. (Viceversa it may be supposed that the free exchange rate had been very much determined by the anticipated level of the new parity.) All the same, the fixing of the new parity above the last market rate does not admit of any judgement whether one has “allowed for” further developments, i.e. whether a possible further falling back of our cost and price increase behind that abroad has been anticipated. For, the last “free” exchange rate of the DM cannot unreservedly be regarded as an “equilibrium price”. Without doubt, an exchange rate previously fixed at a wrong level requires much more time to find a new “equilibrium”. In any case during the phase of complete flexibility short-term forces were involved that impeded an “adequate improvement” of the exchange rate: the reflux of “hot” foreign money set in. How strong such an influence may be was proved by the permanent “sticking” of the exchange rate to the upper intervention point of DM 3.69 per dollar during the first week after revaluation.

Whether or not the new exchange rate is a relatively high one, can finally be ascertained only by the attempt of an analysis of effectiveness. A government facing the decision to change the parity of the national currency will naturally have to undertake such an analysis previously. Certainly this was done. At any rate, when the Govern-

ment took its decision, it had such an analysis of effectiveness at its disposal. It had been worked out by the Association of German Economic Research Institutes in mid-October, and was based on a hypothetical rate of revaluation of 7.5 p.c. (instead of 8.5 p.c.) together with a simultaneous abolition of the export tax and import remuneration. This joint expertise investigated the effect of such a revaluation rate on the Federal Republic's economic development in 1970. The quintessence: “In spite of revaluation the external contribution<sup>1</sup> in nominal terms will not decline remarkably; at prices of 1969 (i.e. in real terms; the author), however, the effect should be quite considerable<sup>2</sup>.”

## Analysis of Effectiveness

The revaluation of the DM is designed to abolish the divergence of costs and prices between the Federal Republic and foreign countries. If this disparity could be ascertained with an adequate accuracy, this would provide an ideal yardstick for the correction of the exchange rate. But such calculations are extraordinarily problematical, beginning with the selection of the base year of the comparative calculation up to the question of comparability of

<sup>1</sup> The external contribution is the balance of exports and imports of goods and services within the concept of the national accounts.

<sup>2</sup> Association of German Economic Research Institutes: *Die Lage der Weltwirtschaft und der westdeutschen Wirtschaft im Herbst 1969 (The Situation of the World Economy and the West German Economy in Autumn, 1969)*, p. 11.

statistical data<sup>3</sup>. If the elimination of the divergence vis-à-vis foreign countries is successful, then German goods and services are not "comparatively cheap" anymore on the world market, and foreign goods are not "relatively expensive" anymore for Germans. Thus far a tendency towards a reduction of exports surpluses will set in, the risk of an imported inflation will dwindle — no matter, whether it is, in the first place, to be traced back to international price structures, income effects of high surpluses or on liquidity effects. Thus revaluation is on principle a suitable method for restoring the external equilibrium, and simultaneously of contributing to the restoration of the domestic equilibrium.

The actual effect, however, depends to a high degree on three factors:

- ☐ On the suppliers' attitude as regards prices.
- ☐ On the buyers' reaction to price changes, i.e. on elasticity of demand with regard to prices.
- ☐ On economic policy which, when occasion arises, must prevent by flanking measures that the contractive effect on incomes of revaluation does not damp imports too much and thus cancels more or less the import stimulating price effect.

#### Estimation Difficulties

Quantitative statements on the effects of a revaluation are so difficult because, above all, these three factors are so hard to estimate. Furthermore the delay of effectiveness is to be con-

sidered. In foreign trade it is considerable, because there are extensive backlogs of orders, which for months still determine deliveries. Only after their reduction, reactions to revaluation can make themselves felt more strongly. Short-term effects could virtually exist alone in the fact that "the anticipation of increasing foreign competition in domestic and international markets brings about a certain cautiousness with regard to prices<sup>4</sup>."

Quantitative deliberations have to start from the fact that in exports of goods the price increase of 9.3 p.c. caused by revaluation is combined with the abolition of the export tax of 4.0 p.c., which, however should only in part be passed on to prices. The price elasticity of demand abroad for German goods on the whole seems to be comparatively low, i.e. a price increase by 6 p.c., for instance, does not induce the quantity of sales to decline by a corresponding percentage. Foreign exchange proceeds even increase, but calculated in DM they decline — always compared with a situation without a revaluation. In imports, price decreases by 8.5 p.c. for industrial products caused by revaluation are partly offset by the abolition of the import remuneration of 4 p.c. If then foreign suppliers

<sup>3</sup> Calculations of the disparity of exchange rates are to be found in "Geschäftsbericht der Deutschen Bundesbank für das Jahr 1968 (Annual Report of the German Federal Bank for 1968), p. 20. See also "Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung" (Council of Experts on Economic Development): Alternativen außenwirtschaftlicher Anpassung, Stuttgart and Mainz, 1968, graph 23.

<sup>4</sup> Hamburgisches Welt-Wirtschafts-Archiv (The Hamburg Institute for International Economics): KONJUNKTUR VON MORGEN, No. 297 (1969), p. 2.

use part of the remaining margin for price increases, a very modest price reduction will result for imported goods.

#### Unjustified Lamentations

The effects of DM-revaluation will not yet be impressive in 1970. This results not only from the delay of effectiveness as depicted above but also from the fact that the revaluation rate, due to the abolition of the export tax and the import remuneration in merchandise trade, is not particularly high. Related to the net position on goods and services it corresponds to a revaluation which is about 1 p.c. higher than that of 1961, which amounted to 5 p.c. and 4.75 p.c., respectively. The external contribution in nominal terms, that in 1969 amounts to more than DM 15 bn, will reach in 1970 about DM 14.5 bn. But the quantity-effect and its influence on production is stronger. Taken by itself, it does not endanger the high level of employment. True, the effects of revaluation will not cease to exist at the end of next year, and the tendency towards an equilibrium in foreign trade and payments will thereafter become more distinct. Whether the reduction of the external contribution to 1.5 p.c. of the GNP<sup>5</sup>, aimed at by the Federal Government, can be reached before long, depends above all on the future development of costs, prices and incomes at home and abroad. Lamentable warnings foreboding poor times for German foreign trade are in any case unjustified.

<sup>5</sup> Annual Economic Report 1969 of the Federal Government, Bundestagsdrucksache V/3786, p. 35.



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