

Richards, Kenneth

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The Currency Crises of the Sixties

by Kenneth Richards, Aberystwyth *

The past decade has been one of the more eventful periods in the history of the international monetary system, having been punctuated by two major gold crises in 1960 and 1968 and no less than four major sterling crises in 1961, 1964, 1966 and 1967. In addition, the DM has been revalued upwards on two occasions, while the French franc was devalued in 1969, having been previously devalued in 1958. These crises in turn have prompted remedial measures in the form of international co-operation to counter speculation, the creation of a two-tier gold system and a new international reserve asset. At the beginning of a new decade it might be worthwhile to survey the crises in the light of the problems facing the international monetary system and the measures taken to tackle them.

Three main problems facing the present world monetary system may be distinguished; those of adjustment, liquidity and confidence, and although the three are closely inter-dependent it is analytically convenient to discuss each problem separately.

Problems Facing the UK and the USA

The problems of the United Kingdom and the United States will occupy the major portion of this paper since the sterling and the dollar are "key" currencies, widely used as trading and reserve media. A brief discussion will follow later on the problems facing France and Germany.

As may be seen from Table 1 below, the history of the UK and US balance of payments position has been on average one of fairly substantial deficits on combined current and long-term capital account ("basic" balance), although the component items differ markedly.

On the one hand, the UK experienced deficits on both accounts; on the other, the US current account position, in spite of massive expenditure on the Vietnam War, was relatively strong. The

net outflow of US private and public long-term capital, however, more than compensated for this favourable position.

Finance for these deficits was provided for the most part by increases in liabilities outstanding in sterling and in dollars, together with depletions in gold reserves especially in the US. Recent balance of payments practice in the US has tended to highlight the effect of these liabilities by means of a "liquidity" balance which measures increases in liabilities to private and official foreign lenders (but which excludes claims) and changes in the reserves. As may be seen from the table the US liquidity deficit was almost double the basic balance on average for the years indicated.

Table 1
UK and US Balance of Payments Position, 1958–67
(Average annual surplus (+) or deficit (–))

	UK £ mn	US \$ mn
Trade Account	–241	+426
Current Account	–43	+374
Long Term Capital	–158	–502
"Basic" Balance	–201	–138
"Liquidity" Balance	.	–274

Sources: CSO, UK Balance of Payments, 1968. Economic Reports of the President.

Various measures were taken to try to rectify the worsening payments positions of the two countries, including the devaluation of sterling in November 1967. Although all of the expedients, with the exception of devaluation, achieved limited success only, paradoxically the solution of the UK and US problems would create further problems for the liquidity of the present international monetary systems, the inherent instability of which was highlighted by Professor Robert Triffin in 1958¹.

Deterioration of Reserve Positions

The sources of liquidity, broadly defined as the amount of internationally acceptable assets available to countries to finance imbalances in their balance of payments, have been gold, sterling and dollars. While the pound was the most important reserve currency up to the Second

* University College of Wales.

¹ R. Triffin, *Gold and the Dollar Crisis*, New Haven Yale University Press 1960.

World War, since that time the dollar has gained pre-eminence. Gold has declined in relative importance, and in addition the net reserve positions, as measured by the ratio of reserves to liabilities outstanding, of both the UK and the US have deteriorated.

As far as the UK is concerned the dramatic change in its net reserve position occurred during the Second World War when it accumulated massive sterling liabilities to pay for the war effort. At the end of the third quarter of 1967, the eve of the devaluation crisis, total liabilities stood at £4,528 mn compared to reserves of gold and foreign exchange of £976 mn.

In the case of the United States, a marked deterioration occurred in its reserve position between the end of 1958 and 1967, the eve of the second gold crisis of the sixties, a pattern which bears out the deficit figures quoted earlier, and the policy of some countries such as France of converting their dollar holdings into gold. At the end of 1958 total reserves were equal to \$22,540 mn compared to liabilities of \$15,578 mn; in 1967 the respective figures were \$12,830 mn and \$34,047 mn.

Lack of Confidence

The deterioration of the reserve position of the two key currencies brings us to the third problem of the international monetary system, that of confidence. One of the features of the system is the maintenance of relatively fixed exchange rates and of the convertibility of currencies into each other at these rates and of the dollar into gold at the par value of \$35 an ounce. A declining ratio of reserves to liabilities brings with it the fear that a sudden run on any currency could not be met out of reserves, while the very fact of persistent deficits makes a country's currency susceptible to devaluation. The result is that at times of confidence crises, there is a rush out of sterling into dollars or other currencies and, in the case of the dollar, a rush into gold, since a devaluation of the dollar would involve an increase in the price of gold.

Currency crises may be grouped under two main headings; bear speculation about the currency liable to be devalued, and bull speculation against some other currency likely to be revalued upward. An example of bull speculation occurred in March 1961 at the time of the revaluation of the DM and the guilder, which resulted in pressure on sterling at a time when the British balance of payments was in surplus. Again in May 1969 expectation of a DM revaluation brought heavy pressure to bear on the pound.

It is probably true, however, that fears of a sterling devaluation prompted the speculative pressure in November 1964, when the expected deficit for the year had been estimated in the region of £700–800 mn, which eventually turned out at about £770 mn. The same is true of 1966 and 1967, although some measure of success had been met in reducing the deficit of the former year.

The severity of the sterling crises led to a recognition that international co-operation was required to counter speculative movements of funds. Action was taken on two fronts, that of short term credit arrangements directly between central banks and of longer-term credit facilities within the International Monetary Fund.

International Co-operation Required

It was during the sterling crisis of March 1961 that various informal arrangements were worked out, later known as the Basle agreements, among central banks for mutual support of their currencies during speculative attacks. The latest of these was the Basle agreement of September 1968 whereby the UK authorities gained access to a medium-term loan facility of \$2,000 mn to replenish reserve losses as a result of conversion by Sterling Area countries of their official sterling balances, the first of this type of agreement having been a short-term credit arrangement concluded in 1966.

In addition, various bilateral swap agreements have been negotiated whereby central banks exchange deposits at the appropriate rate of exchange mutually creating "instant" reserves as a result. The latest of these to emerge came after the DM-speculative crisis of May 1969, and provides for countries gaining funds automatically relending these to losing countries, previous arrangements having been in the nature of conditional borrowing facilities only.

Besides the short-term borrowing arrangements, longer-term facilities within the IMF have been increased, the last increase in quotas (and hence in borrowing rights) being in 1966. Moreover, the General Arrangements to Borrow which had been concluded early in 1962, whereby the ten major participants in the fund had agreed to make additional facilities available to the latter wherever its resources were depleted by borrowings in the face of speculative attacks.

These palliatives were not designed to cope with the problem of adjustment. The main weapon to solve the latter problem in the UK has been that of devaluation, which has achieved a substantial degree of success to date. The devaluation of sterling, however, left the dollar in the

front line of speculative attack which resulted in the second major dollar crisis of the sixties. The first occurred in October 1960 on the London gold market, when rumours of a change in the policy of the US and UK authorities of supplying gold to the market to hold the price just above \$ 35 an ounce, led to a jump in the price to \$ 40 on October 20th.

Two-Tier Gold System

Amongst the policy changes made at that time was the formation of a gold pool in which foreign official institutions participated with the US in supplying gold to meet the private demands. This pool was placed under severe pressure in March 1968, the gold reserves of the seven member countries falling by some \$2,045 mn during the first quarter of the year.

Emergency action became imperative, and the result was the creation of a two-tier gold system whereby the market was divided into two sections—the official market within which gold would be bought and sold between central bankers at

\$ 35 an ounce, and the private market which was to be left to determine the price by means of the free interplay of supply and demand. The position of South African gold rules was not clear at the time but has now been clarified by agreement with the IMF in December 1969 whereby South Africa will sell gold both to the Fund and on private markets in accordance with its needs to obtain foreign exchange to settle payments imbalances².

After a period of substantial fluctuations the free market price seems to be approaching the central bank price as speculators now see the prospects of an increase in the official price of gold as being very dim indeed. The two-tier system seems to have been successful, therefore, in shielding the US gold reserves from speculative attack.

While sterling and dollars have been very much in the limelight of international currency speculation, with fears that changes in their par value

² For details see IMF International Financial News Survey, January 16, 1970.

INDUSTRIE UND EWG

8. Frankfurter Gespräch der List Gesellschaft · 4. und 5. Juni 1970

Referate und Protokolle · Im Auftrag der List Gesellschaft herausgegeben von *Thomas Richers*
(Veröffentlichungen der List Gesellschaft e.V. 68) · 1970. XI, 195 Seiten. In Leinen gebunden DM 18,50

At the latest meeting of the List Society — June 4–5, 1970 — representatives of science, policy, administration, and finance attempted to arrive at a result of accomplishments of integration so far and to work out priorities for leading up to conditions similar to a home market. This volume contains the minutes and the reports of the meeting, which was attended by representatives of practice, EEC policy and science. The necessity of future EEC policy was again underlined.

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J. C. B. Mohr (Paul Siebeck) Tübingen

would, as a result of their critical importance as reserve currencies, cause international monetary collapse, the French franc and the DM have occupied relatively minor positions.

Devaluations of the Franc

Having achieved a brilliantly successful devaluation of the franc in 1958, inflationary tendencies subsequently crept into the French economy and by 1963 were undermining French international competitiveness. The situation was brought to a head by the industrial disputes of May 1968 and the consequent inflationary wage settlements. The flight from the franc developed in November, when the bank of France lost foreign exchange to the extent of about \$ 150 mn. Most of the money went to Germany, where there were expectations of a DM-revaluation. In a sense this was both a bull and a bear speculative flight of funds, since had both parities been changed vis-à-vis the dollar, operators buying DM with francs would have made a double gain on the deal.

Although the franc was not devalued in November 1968 as expected, the parity was lowered by 11 p.c. in August 1969 at a time when no one was expecting it and thus gave speculators little chance of capital gains at the expense of the reserves³. In a sense, the French devaluation was really a measure designed to correct ex ante rather than ex post deficits since the French balance of payments did not go into basic deficit until 1968.

Germany's Experience

Finally, the experience of the Federal Republic in the sixties is the exact opposite of that of the US, the UK and France, since Germany has been plagued by chronic balance of payments surpluses, which in turn have imparted inflationary tendencies to the economy.

In response to these kinds of influences, the DM was revalued upward by 5 p.c. in March 1961, a move which seemed to set off destabilising speculation, since its money flowed into

Germany in the expectation of a further revaluation, the Bundesbank absorbing over \$ 300 mn worth of gold and foreign exchange in the two weeks following revaluation. Although the parity change resulted in a basic deficit in 1962 and in a number of other subsequent years, by 1966 chronic surpluses were again manifest. In November 1968 there was further speculation regarding a possible realignment of the parity of the DM, the German authorities responding *inter alia* with a number of border tax adjustments designed to make exports dearer and imports cheaper.

However, further speculation developed in May 1969, when about \$ 3,000 mn is estimated to have poured into Germany. Eventually in September 1969, the DM was allowed to fluctuate freely on the foreign exchange market where it appreciated sometimes by as much as 7 p.c. At the end of this experiment, the German authorities established a new par value with the IMF which represented an appreciation of about 8.5 p.c. on the old par value, and a return to a fixed exchange rates.

Conclusions

In retrospect, the decade of sixties has witnessed substantial upheavals and achievements in the international monetary sphere. Massive flows of hot money from one country to another have stimulated international cooperation on a large scale. The two-tier gold system seems to be an unparalleled success, while the parity changes mentioned seemed to have gone a long way towards correcting unrealistic exchange rates.

Perhaps the greatest achievement of the decade, however, lies in the recognition of the inherent weaknesses of the gold exchange standard and the desire to have a more rational means of increasing international liquidity. On January 1st, 1970, the first allocation of Special Drawing Rights (SDR's) within the IMF were made. They represent for the first time a genuine credit instrument and one which will be unconnected with the fortunes of any particular country. In the distant future, they may even entirely usurp the function of dollars, sterling and gold as reserve assets; meanwhile a start has been made.

³ This contrasts with the British devaluation in November 1967 when the reserves were estimated to have suffered substantially from Bank of England support of both spot and forward sterling.



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