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Multinational Firms and the Currency Crisis

by Dr Max Iklé, Zurich *

Every currency crisis of recent years has been accompanied by a migration of billions of short-term money. Both experts and laymen have again and again been amazed at the speed at which, at relatively short notice, these enormous sums could be mobilised.

There is a great variety of theories about the movements of short-term money, which are measured in many billions. Currency experts tend to see the culprit in the Euro-dollar market. Since the total volume of this market has been estimated at over \$ 50 bn, the impression was created that it consists of an immense reservoir of short-term funds, which are available at any time and practically at call. However, this impression is deceptive. The said market largely consists of a closely interwoven network of credit accounts and debts, in which the ultimate recipients of dollar payments have passed on these dollars to their own national bank, or have repaid debts of their own in relation to an US creditor. The ultimate foundations of the Euro-dollar market are liquid dollar credit accounts, which are by far not as extensive as is always being suspected. It may even be the case that the liquidity of this market might have recently dried up, if central banks had not made investments in it.

Behaviour of Speculators

Other observers of the scene believe that "speculators" are responsible for the recurrent crises, because these allegedly mount an assault on one, and then on another individual currency. The main aim of such criticism are multinational enterprises, i.e. corporations whose activities are worldwide. But in what way should such commercial and industrial groups conspire to mount such an all-out offensive, and what could be their interest in causing currency crises? On the contrary, it seems well-nigh impossible that several hundred such giant companies could come to a joint accord on staging such a concerted attack, especially since they usually are not enmeshed in a network of cooperation. Moreover, their in-

terest in causing a currency crisis is nil, because it is in their vital interest that the international currency system operates without friction. Accusations of this kind are therefore nothing but horror stories, born by a fertile imagination. Yet it need not be denied that the behaviour of multinational concerns might eventually contribute to making an existing currency crisis worse. But if this happens, it will never be the result of a pre-planned campaign — its causes are fundamentally different.

Alms of Multinational Concerns

Multinationally structured concerns naturally operate finance departments, whose heads make it their duty to observe carefully all developments in currency markets. Among other things, it is their task to minimise losses which their firms might suffer from the fluctuation of currency values. They therefore not only regularly analyse the balance of payments of all important trading countries, but they carefully register all the pronouncements of expert bodies and responsible ministers. Should a given currency come under suspicion that its devaluation is in the offing, national subsidiaries and/or associate companies which operate in the country so suspected will be asked to repay their foreign currency debts before they fall due, and the liquid funds of the group will be transferred to other countries. Remaining currency risks will be covered in the optimal manner, by selling futures or by credit operations. Conversely, if a given currency is being talked about as a candidate for revaluation, subsidiaries and associates will be asked to pay off such debts as are owed in that currency, and to avoid incurring new debts in it. At the same time freely available liquid funds of the group will be channelled to the largest possible extent into the country whose currency may be revalued. Whilst

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individuals and small firms may have difficulties in operating along such lines, international groups usually have ample facilities for finding foreign currency to build up hedges against such fluctuations. If the group's parent company is registered in the USA, any dollar sum can be made available within hours, and the parent will not be constrained to calling on the Euro-dollar market for currency credits. European-based parent companies, on the other hand, may use their banking contacts and/or US-based subsidiaries and/or associates for obtaining dollar credits of any needed size.

Switching Operations in Advance of Parity Shifts

But the finance departments of such companies have, in addition, also the duty to provide sufficient working capital for the group, at any time, for financing current operations. They must keep in hand sufficient funds of those currencies which probably will be needed in the near future. For companies which are not US-based such funds will mainly have to consist of US dollars, needed for buying raw materials and also for buying other currencies. If there are plenty of dollars in the company's treasury, the finance departments must invest them as profitably as possible. Until some time ago, this kind of operation was usually managed by the group's "house banks". But more recently, groups tended to prefer looking after this side of their business themselves, in order to benefit from the high profit margins which, from time to time, could be earned in the Euro-dollar market. Decisions of the multinational corporations' finance departments are determined by their evaluation of, on the one hand, the prospective profit margins, and, on the other hand, the currency risks. Rates of interest, for example, were extremely high in the Euro-dollar market in 1969, and consequently, the dollar funds entering it were then considerably increased. This was reflected by the US-statistical returns on dollar holdings of the companies based outside the USA. These had reached \$ 28 bn at the end of 1969, but by the spring of 1971, they had contracted again to a mere \$ 18 bn.

Large-scale switchings of this kind, which could be observed several times in recent years, will always only be undertaken when changes in currency parity were believed to be imminent. Forebodings announcing such changes during the crises of recent years have been contained in statements made by the various national government's economic advisers, by parliamentary committees, and in some cases even by responsible ministers. Several examples illustrate the case: The report of the German Economic Experts' Council of early May, 1971, which recommended,

among the plaudits of the Federal Government, a revaluation or the floating of the DM, set in motion an estimated \$ 3 to 3.5 bn, of which \$ 2 bn migrated to the Federal Republic of Germany and the balance to Switzerland and a number of other European countries. The report of the US Congressional Currency Sub-Committee, under the chairmanship of Mr. Reuss, had the effect of driving out of the United States as much as \$ 9 bn. And a study published by the International Monetary Fund, which quoted certain likely devaluation and revaluation rates, drove even the most phlegmatic managers of multinational corporations' finance departments to convert their dollar balances into other currencies. The mere decision to let the DM parity float would not have been likely to drive the rate of DM up by a full 10 p.c., and the same is true of other currencies. Every such pronouncement was the signal for a new war of nerves to start, which set vast sums wending their way towards higher currency values, and it was this migration which enforced such high rates of appreciation.

Role of International Trade

It can be therefore affirmed that multinational concerns do not cause currency crises. During currency crises, they act financially in accordance with their rights and duties, which prompt them to hedge against any harm that might befall them from fluctuations in currency rates. The actual reason of such enormous money transfers, however, is the vast publicity surrounding all currency questions, in contrast to former times when it was usual to deal with such problems in conditions of maximum privacy. The force of the veritable torrent of money that pours through the open sluice gates often deprives monetary authorities of their liberty to act freely. They sometimes have no choice but to capitulate when facing the momentum of currency moves.

But not only multinational groups exert an influence on currency markets, for international traders also tend to hedge against currency fluctuations. In countries which are prone to an early devaluation, they will pay off their debts before they fall due, whilst leaving their credit balances to stay in hard-currency countries for longer than otherwise customary. This phenomenon is known as leads and lags, and it is given to distorting normal money movements to such an extent that countries whose currencies are suspected of a devaluation suffer from big deficits. Examples are the sterling crisis after 1964 and the events of recent months, when the future fate of the dollar was under discussion. It is estimated that annual dollar transactions have a normal volume of about \$ 125 bn. This makes

it less than surprising that about \$ 23 to 24 bn have fled the USA during the first eight months of 1971, of which only some \$ 9 bn were used for redeeming short-term indebtedness and for covering the fundamental US-payments deficit. In view of the fact that the volume of world trade has doubled during the past decade from 1960, reaching \$ 300 bn in 1969, whilst US-direct investments abroad rose from \$ 32 to 71 bn—and allowing for the fact that US-based parent companies are financially much stronger still—it must be stated that official pronouncements about the possibility of parity shifts are a dangerous play with fire.

Sources of the Dollar Surfeit

Making up a final account about the sources from which the dollars flow which have inundated non-American central banks over the last two years, thus causing the international currency crisis, and trying to isolate, in this context, the contribution made to it by multinational companies, the following picture emerges in broad outlines:

☐ About \$ 10 bn of private funds have been deposited with central banks, reflecting the retreat of private investors from the Euro-dollar market, where rates of interest have declined, and also their fright lest the dollar be devalued relatively to their own national currencies. It may be taken for granted that multinational companies contributed a comparatively high share to this sum;

☐ Another \$ 10 bn were repaid to the Euro-dollar market by US-banks and absorbed by European borrowers. Among the latter, big German concerns—of which not all can be dubbed multinational—have played an important part. They have taken up, from the beginning of 1970, an estimated total of perhaps \$ 8 bn, mainly in the Euro-dollar money market.

☐ \$ 10 bn were represented by investments of central banks in the Euro-dollar market, and these

sums were flowing, by devious ways, back to other central banks, which means that they entered into multiple transfers. Multinational companies can in no way be held responsible for such moves.

☐ Perhaps another \$ 10-15 bn may be accounted for by leads and lags and by currency switchings operated by multinational concerns. To what extent it was international trading firms and to what extent multinational concerns which were involved is difficult to assess, but it is likely that traders claimed the larger share.

☐ And finally, \$ 8 bn are represented by the basic deficit of the US-balance of payments.

Careful Realignment of Currency Rates

The figures that have just been quoted naturally represent only rough approximations to reality, but they are sufficiently reliable for showing to what extent multinational groups may have influenced currency developments during the past two years. They also show what would be the further shifts from the moment onwards when agreement will have been reached about the realignment of currencies and when the US-balance of payments has returned to equilibrium. It may be assumed that leads and lags will then return to their normal sizes, that multinational companies will alter their financial policies, and that dollar holdings will swell again. This would lead to a considerable growth of demand for dollars, concomitant, probably, with rising rates of interest in the Euro-dollar market and with a re-routing of the currents of the short-term money flow. European central banks, on the other hand, being wise after the event, will probably leave the Euro-dollar market alone in the future. This suggests that the flow of the dollar may take a different direction. It can therefore be concluded that any new agreement on currency rates will have to be hammered out with the greatest circumspection, in order to prevent too strong a move of the pendulum in the opposite direction.



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