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Solo Exercise in Stabilisation Policy

The Federal Republic of Germany is trying to restore its reputation as a country attached to stability which has become somewhat tainted by the price surge: in May German consumer prices were about 8 p.c. up on the same month last year, which is quite as much as in most other countries of Europe. It has also been tainted by the conduct of the Federal Government which needed a long time to appreciate the gravity of the situation with which its stabilisation policy has to cope. Many observers even had a feeling that for quite a while the Government did not want to see it. But this is past history. By its stabilisation programme of May 9 the Federal Government has switched over to the course of restriction. It is now acting in concert with the German Bundesbank.

The Federal Republic has thus chosen to go ahead by itself along a course which is to lead back to slower rates of price increase. For a long time the Government had insisted that the stabilisation policy could, and therefore should, be undertaken as a joint operation, at least by the European Community countries, if not by an even larger grouping of states. The argument which it advanced made good sense. Given fixed exchange rates, the success of single-handed action by any one country can under the present conditions of closely integrated trade and money flows at best only be short-lived. For restrictive credit conditions tend to attract foreign monies, damping-down of domestic demand draws manufacturers into an export drive, and if prices in one country lag behind those in all others, they activate the mechanism known as international price correlation. All this, as has been pointed out, applies only if exchange rates are fixed. To the Federal Government these rates were until recently taboo.

That it is now acting by itself is, first of all, due to the force of circumstances. German public opinion felt so perturbed over the soaring prices that the Government had to take action. The EC partners were not willing to adopt appropriate policies, and with the débâcle of the Paris summit of October 1972 in mind nobody can have been surprised at their attitude. Since then however, it can be pointed out, the conditions governing the foreign exchange rates have undergone

a remarkable transformation: a bloc of European countries (which now includes the Benelux countries, Denmark, Norway and Sweden as well as the Federal Republic and France) is floating jointly against the "rest" of the world, which means chiefly the US dollar.

A potentially important disruptive element has no doubt been eliminated thereby, especially as far as monetary policy is concerned. But if this is now officially given out to mean that floating en bloc protects the external flank, it must be said that this is certainly not true in such generalised terms, not even on the assumption that the bloc will stand up to French pressure for inordinate intervention in support of the dollar rate.

It is a fact that the complex of external problems involved in a stabilisation policy pursued by the Federal Republic in isolation has been no more than narrowed down to the circle of the bloc members. They absorb 38 p.c. of German exports and supply 44 p.c. of its imports. The magnitude of this trade indicates the range in which all the fixed exchange rate problems of screening a restrictive policy against outside influences continue to apply.

Whether they will not be further aggravated in practice depends on the kind of joint intervention policy which the "bloc floaters" pursue towards the US dollar. They would be aggravated if the French view were to prevail and the dollar were supported by massive purchases. So there is a real danger that the restrictive policy of the Federal Republic will soon once again come up against external limits. Whether foreign monies are going to flow in on a major scale will, in view of the instituted dirigismes, depend on the motives for such movements. The walls may well hold against interest-induced flows: but if they are inspired by expectations of a revaluation, the net will be seen to leave loop-holes.

That however is not the only worry. A further strong upsurge of foreign demand could create as great a hazard as speculative inflows of foreign currencies. In the circumstances it remains to be seen whether a single-handed stabilisation policy will not, in the end, necessitate single-handed floating.

Hans-Jürgen Schmahl